Annual Report

United Utilities Group PLC

Annual Report and Financial Statements
for the year ended 31 March 2016

United Utilities
helping life flow smoothly

United Utilities is the UK's largest listed water company

Through its subsidiary, United Utilities Water Limited, it manages the regulated water and wastewater network in the North West of England, providing services to around seven million people and businesses. The vast majority of the group's assets and profit are derived from its regulated UK water business.

Our vision

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

Where we operate

Key facts

We help to protect over 400km of coastline and around 7,000km of rivers flowing through the North West

We deliver around 1,700 million litres of safe clean drinking water to our customers every day through around 40,000km of water pipes

We produced 138 GWh of renewable energy in 2015/16 through sludge treatment centres and solar installations, enough to power over 40,000 homes

We look after more than 55,000 hectares of catchment land, helping to protect the quality of our water resources

Our approach to sustainable shareholder value creation

- Clear vision to be the best UK water and wastewater company, providing great service to our customers
- Management team with extensive commercial, operational and regulatory experience
- Track record of regulatory outperformance; exceeded 2010–15 targets
- Wholesale revenue and asset base linked to RPI inflation to at least 2020
- Clarity on allowed returns through to 2020
- Significant improvements in customer service and operational performance, with more to come
- Externally recognised responsible business credentials
- Customer and environmental benefits delivered through substantial capital investment, which drives long-term growth in the regulatory capital value
- Robust capital structure: stable A3 credit rating
- Sustainable dividend policy targeting a growth rate of at least RPI inflation per annum to at least 2020
- Total dividend per share of 38.45 pence for 2015/16

What's in this report

Our annual report and financial statements aims to meet the information needs of our investors as a whole, to help them to make informed decisions regarding their participation – for example, whether to buy, sell or hold our shares or bonds, whether to engage with management on issues and how to vote their shares. This includes information which we believe is material to these decisions and we present it in a way which we believe is fair, balanced and understandable.

We recognise that this report will be read by a wide variety of other stakeholders including customers, suppliers, employees, contractors, competitors, government, politicians, regulators, press, analysts and non-governmental organisations. Where we believe that a topic is material to a large number of them we either include it in this report or cross refer to other reports and information (such as our customer communications, our sustainability web pages or our regulatory reports).

We believe this approach meets the requirements of company law, the UK Corporate Governance Code, IFRS and the <IR> Framework and that we go beyond those requirements where we feel it is particularly helpful to do so and where that can be done without making the report unnecessarily lengthy or difficult to read.

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:
Unless expressly stated otherwise, the 'group', 'United Utilities', 'UU' or 'the company' means United Utilities Group PLC and its subsidiary undertakings; the 'regulated business', 'regulated activities' or 'UUW' means the licensed water and wastewater activities undertaken by United Utilities Water Limited (formerly United Utilities Water PLC) in the North West of England.

Integrated report

This annual report has been prepared in accordance with the International <IR> Framework published by the International Integrated Reporting Council in December 2013.

Operational highlights 2015/16

Accelerated investment to deliver early operational benefits:

£799m

capital invested in 2015/16

Further improvements in customer satisfaction: Service Incentive Mechanism score up year-on-year

Reward of:

£2.5m

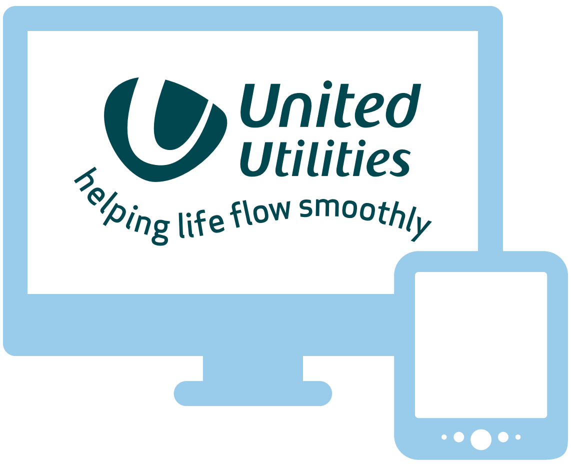
achieved on outcome delivery incentives, against a tough set of targets

'Water Plus' Business Retail JV with Severn Trent: First mover advantage and economies of scale

Retained 'World Class' rating in Dow Jones Sustainability Index and sector leading status

See how we performed against **Our Operational KPIs** on page **29**

Read more about **Our Operational Performance** on pages **31** to **38**



Online annual report

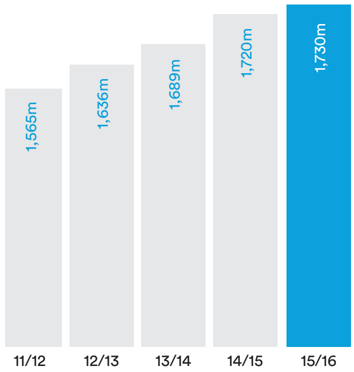
Our annual report is available online at:

corporate.unitedutilities.com

Financial highlights 2015/16

Revenue

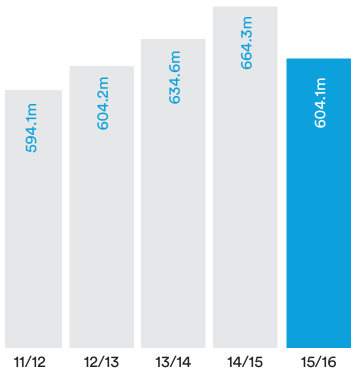
£1,730m



Revenue was up £10 million at £1,730 million, despite the new regulated price controls. This is because we benefitted this year from higher than assumed volumes, along with an increase in non-regulated sales, and last year was impacted by the £21 million special discount we applied to customer bills.

Underlying operating profit*

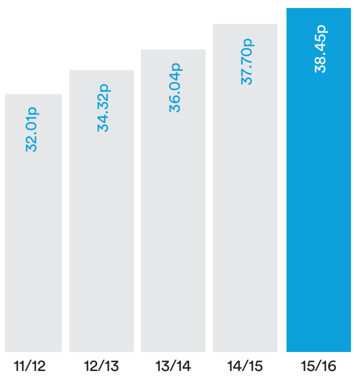
£604.1m



Underlying operating profit was lower by £60 million, at £604 million, as expected, reflecting the new regulated price controls, an increase in infrastructure renewals expenditure as we accelerate the investment programme to deliver early operational benefit, along with increases in depreciation and other costs, partly offset by a reduction in bad debts, power and regulatory fees.

Total dividend per share

38.45p



Total dividend per ordinary share for 2015/16 of 38.45 pence. This is an increase of 2.0 per cent on last year, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

See how we performed against **Our Financial KPIs** on page **28**

Read more about **Our Financial Performance** on pages **39** to **45**

* A reconciliation between underlying operating profit and reported operating profit is shown on page 44.

Delivering our strategy

The strategic report details our performance over the past year and how it has been achieved alongside our vision and strategy for future years.

Pictured: We've installed Europe's largest floating solar power project at Godley reservoir in Greater Manchester.

Read the full story on page **37**

Strategic Report

Chairman and Chief Executive Officer's review

Steve Mogford, Chief Executive Officer and **Dr John McAdam,** Chairman

We are pleased to report a continuing improvement in underlying performance and customer satisfaction, in a year that presented some difficult operational challenges.

This is the first year of the new 2015–20 regulatory period and one in which, notwithstanding several challenges, we took another step towards our vision of becoming the UK's best water and wastewater company, providing customers with great service.

Financial performance

We improved performance for shareholders and customers over the last regulatory period providing a strong platform for us to deliver further value across the 2015–20 period, including sustainable dividends.

Group revenue was slightly higher than last year, up £10 million at £1,730 million, as the impact of lower allowed regulated revenue for 2015/16 was more than offset by higher than assumed volumes and an increase in sales in our non-regulated business. Underlying operating profit, at £604 million, was in line with management expectations, albeit £60 million lower than 2014/15, following the new regulated price controls and impacted by the planned acceleration in our investment programme. Underlying profit before tax, at £408 million, was down by £39 million, as we benefitted from a £21 million reduction in underlying net finance expense. Underlying earnings per share was 47.7 pence, more than covering the dividend. The board is proposing a final dividend of 25.64 pence per ordinary share, making a total of 38.45 pence per ordinary share for the 2015/16 financial year. This represents an increase of 2.0 per cent, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

To support the retention of a robust capital structure, we aim to maintain efficient access to debt capital markets throughout the economic cycle. We have debt costs locked-in at attractive rates and are on track to beat Ofwat's allowed cost of debt for the 2015–20 period. The board believes it is appropriate to keep gearing, measured as net debt to regulatory capital value, within our existing target range of 55 to 65 per cent. We aim to maintain, as a minimum, our existing credit ratings of A3 with Moody's and BBB+ with Standard & Poor's for United Utilities Water Limited.

Customers

In recent years, we have made great strides in improving customer satisfaction, underpinned by better operational performance. We are pleased to report another year in which underlying customer satisfaction has again improved. However, the last 12 months presented a number of very significant operational challenges and we feel it is appropriate to note the enormous effort by the company's employees, its partners and other stakeholders to sustain water and wastewater services to customers.

Water quality incident

On 5 August 2015, routine sampling identified contamination by cryptosporidium of water leaving our treatment works at Franklaw, affecting over 300,000 homes and businesses in Lancashire. With public health our first priority, we quickly moved to issue an advice notice to affected customers advising they boil their water before drinking it, whilst we sought to identify and eliminate the source of contamination. Having made so much progress in recent years, we were disappointed to have inconvenienced customers and we are enormously appreciative of their patience and understanding whilst we worked to address the incident.

We have already acted on lessons learned from the incident (see case study, page 32) and we have worked closely with our water quality regulator, the Drinking Water Inspectorate, on a lengthy and complex investigation into its cause. We await the Inspectorate's report on the matter. We would like to thank all those who gave their support and assistance during the incident.

Flooding

December 2015 will be remembered as an awful time for many customers in Cumbria, Lancashire and Greater Manchester when communities were inundated by flooding caused by unprecedented rainfall (see case study, page 35). The storms at the beginning of December affected over 85 of our wastewater treatment works and a number of other facilities. Dealing with the earlier water quality incident had heightened our readiness. Once again, our appreciation goes to our employees, suppliers and partners who worked tirelessly to maintain the supply of water and return wastewater treatment facilities to service, giving up their Christmas to help families and businesses affected by the floods.

Underlying improvement

Notwithstanding the impact on our customers of the water quality incident and the severe flooding events, we were pleased to see a further improvement in customer satisfaction with an increase in our score on Ofwat's service incentive mechanism (SIM) compared with last year. Considering the challenges associated with the storms, we were particularly pleased that customers rated us 'very highly' for wastewater services where we achieved first place among the 10 water and sewerage companies for the winter period and second place over the full year. We recognise that we have more to do, particularly in respect of our water services. Whilst we are one of the water and wastewater companies with the fewest customer complaints, we are no better than average in how well customers feel we address their complaint. This is an area of particular focus for us and we are revising our training, policies, processes and systems to drive improvement. In addition, we are implementing a new customer relationship management (CRM) system aimed at offering an improved customer experience, as well as delivering further efficiencies in our customer-facing operations. The incidents we experienced last year showed us there is more we can do to help customers at such times and we launched our new 'Priority Services' offer in May 2016. With the help of third sector groups and other stakeholders, we developed an approach to provide targeted support to customers who are experiencing short or long term difficulties and we are working hard to encourage customers to register with the scheme.

Systems thinking

We have coined the phrase 'systems thinking' to capture the key themes of our new operating model, aimed principally at improving the operational efficiency and effectiveness of our wholesale business. We are investing in our new operating model over this five-year regulatory period with efficiency savings contributing to achievement of our totex targets. Those key themes are:

The reliable and efficient operation of our assets. This is critical to both customer service and our environmental performance and we are driving a shift from a reactive to proactive mind-set, seeking, where possible, to address problems before they affect customer service. We are in the final stages of commissioning our new asset management system to deliver much improved preventative and 'on condition' maintenance scheduling and control. We are progressively deploying engineering teams in the field to ensure best performance of our assets throughout their expected life-span – often saving capital expenditure through more effective operational interventions.

Better use of data to monitor, control and optimise asset performance. Our new integrated control centre (ICC) acts as the data hub where we plan, monitor and increasingly control assets. We are close to completing installation of our new telemetry backbone, which acts as the 'data highway' between our assets and the ICC. Under this programme, production sites are being equipped to monitor and optimise site performance.

Think system. Our 91 water treatment works form part of an integrated water supply network and our new production planning system provides real time modelling capability to optimise the cost of total production. It provides us with the capability to re-plan as events occur and this proved invaluable in addressing the considerable water quality challenges created by the storms last year. On wastewater, we are piloting whole drainage area system management, fusing weather and asset data to predict problem 'hotspots' and act to optimise drainage system performance for the benefit of customers and the environment.

Organisation and empowerment. We have shifted away from the typical functional organisation in the water sector to a 'production line' model where multi-disciplinary teams are aligned to water or wastewater production sites and networks. This is delivering much higher levels of performance through increased end-to-end ownership of our assets.

Operational performance

Targeted investment in our assets, processes and the people who operate them has supported sustained improvement in recent years in our environmental performance, as measured by the Environment Agency (EA). We have again been assessed by the EA as one of the best performers in our sector. Performance of our water business scored average or above on four out of six metrics used by the Drinking Water Inspectorate to assess our performance in 2015. However, over the same period, we saw a disappointing growth in the number of water quality events across the business, positioning us in the lower quartile for the sector. We have grasped this issue and set about a number of improvements in training, processes and asset standards. Early results are encouraging and this area will remain a focus of management attention until we are satisfied that the improvement is sustainable.

Performance against our final determination

In setting pricing, we are very conscious of the need to balance investment requirements against the impact on customer bills, particularly given the high levels of economic deprivation in the communities we serve. Our price review settlement includes some challenging total expenditure targets to help deliver this balance. We have worked hard to find ways to make these savings and are pleased to report that we are implementing a range of initiatives to deliver over £400 million of savings to meet our total expenditure allowance, as set by Ofwat. This will still enable us to invest substantially in our assets for the benefit of our customers and the environment. A key feature will be improving resilience, the importance of which was emphasised by the operational incidents we faced this year.

Chairman and Chief Executive Officer's review

Our economic regulator, Ofwat, has introduced a new set of incentives for this five-year regulatory period called outcome delivery incentives, or ODIs. Each carries a potential for penalty or reward based on the company's performance in achieving the operational targets, which generally become tougher over the five-year period. Consultation with customers ahead of submission of our five-year business plan indicated that they were generally content with the level of service provided and so there was little support for rewards attached to ODI performance. As a consequence, our cumulative ODIs are skewed toward penalty with very few areas in which we can earn a substantive reward. At the beginning of last year, we set out a soft target range for our cumulative ODI performance between a £100 million net penalty and a £50 million net reward. We are pleased to report a better than expected performance over the last year resulting in a £2.5 million net reward and we have revised our target range to between £70 million net penalty and £30 million net reward over the five years.

ODIs and the serviceability they represent will benefit from our investment programme in this regulatory period and we have accelerated our £3.5 billion investment programme to deliver improvements as early as possible. During the year we invested £799 million in our assets and systems, around one-third more than the first year of the last regulatory period, and our time, cost and quality index, which measures how effectively we are making that investment, has once again scored highly at around 90 per cent. We expect this front-end loading of investment to continue into the second year of this regulatory period.

Economic environment

Although unemployment in the North West has reduced over the last 12 months, our region continues to have the highest proportion of economically deprived households in England. We have more customers who struggle to pay, with customer indebtedness continuing to be a significant challenge for us.

We place significant focus on helping customers who are struggling to pay and continue to offer a wide range of ways to help them back into regular payment. This includes a new social tariff and an independently administered trust fund for which we increased our annual contribution following a cash tax refund from HMRC. Our new Priority Services scheme supports those customers who may be suffering physical or mental illness as well as those in financial difficulty.

Our debt management processes have been independently assessed as being of a very high standard. We recently implemented a data sharing process with the credit reference agency 'Equifax' and this is helping to distinguish between those customers who are facing genuine hardship and those who try to avoid paying their bill for other reasons.

Non-household retail

We secured our Scottish retail licence in 2012 and have since been a leading competitor in the Scottish non-household (business) retail market. We now have approximately 300 customers, covering around 3,500 sites. Overall, our business retail operation has achieved a net increase in annualised revenue of £18 million. During this period, we have seen a significant increase in the number of active market participants in Scotland and the Water Act 2014 has confirmed plans to open the English business retail market for water and wastewater services in 2017.

We are well advanced in our preparations for full English market opening, having implemented a new customer relationship management system at the end of 2014. However, recognising the relationship between scale and cost to serve for a retail organisation, we saw the benefit of combining our business retail operation with that of another company to create a competitive proposition for the English and Scottish market. We were delighted to find similar thinking in Severn Trent and on 1 March 2016 we announced that we had entered into a joint venture (JV) to combine the two companies' non-household water and wastewater retail businesses, principally comprising billing and customer service activities, to be centrally located in Stoke-on-Trent.

This new company, 'Water Plus', will combine the complementary skills of both companies, including business strategy, sales, customer service and credit management, to deliver an attractive and competitive choice for large and small business customers across England and Scotland. Bringing the businesses together will create a joint venture with the synergies to provide an efficient and cost-effective operation focused on improved customer service and growth.

We are delighted that the JV has received the approval of the Competition and Markets Authority and we are in the process of progressively transferring operations to the new location.

Long-term planning

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

Our Water Resources Management Plan, which describes the projected pattern of water resource activity in our region until 2040, projects that the majority of the North West will be in surplus. Customers benefit from an integrated network that supports movement of water around the region to accommodate its changing supply and demand balance. Our plan includes a new Thirlmere pipeline to extend our integrated network to encompass West Cumbria.

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

Water 2020

Ofwat is assessing a range of options for the next price review, including competition in the areas of water resources and sludge processing, along with the possible transition from RPI to CPI inflation. We have been actively involved in discussions with the industry and regulators and have submitted comprehensive responses to Ofwat's various consultation papers. Ofwat has recently published its views on a range of options for Water 2020 and we are currently undertaking a detailed review of these documents. We will respond in due course, with customers and shareholders at the heart of our thinking.

Responsible business

We aim to build on our notable achievements across the 2010–15 regulatory period and remain highly focused on delivering the best service to customers, at the lowest sustainable cost, while acting in a responsible manner.

Our environmental and sustainability performance has received external recognition. We retained our 'World Class' rating as measured by the Dow Jones Sustainability Index and again achieved industry leading status in the multi-utility/water sector. In addition, at the PwC 2015 Building Public Trust Awards, United Utilities was selected as joint winner for 'Excellence in reporting in the FTSE 100'.

We continue to support partnerships, both financially and in terms of employee time through volunteering, with other organisations across the North West. We recently set up 'Catchment Wise', our new approach to tackling water quality issues in lakes, rivers and coastal waters across the North West.

Our employees

We would not have been able to deliver the significant improvements for customers over recent years without the enthusiasm and commitment of our employees. We are proud of their unrelenting dedication and of our sub-contracting partners who have worked very hard all year round in supporting customers and the environment and we would like to thank them for their significant contribution.

The company has seen significant change over the last few years and we continue to move through a period of transformation, as we respond to the demands of the new regulatory price control. We remain focused on maintaining high levels of employee engagement. Although it has fallen slightly this year at 75 per cent, this continues to demonstrate that our employees have a strong capability to adapt. We have been successful in attracting and retaining good people and have continued to expand our apprentice and graduate programmes, with many now having secured permanent roles across our business. We have received external recognition for our apprentice and graduate schemes.

Health and safety will always be a key focus area and, as part of our health and safety improvement programme, we have implemented a number of initiatives which helped reduce the employee accident frequency rate further in 2015/16. However, we recognise that we still have more to do, as we strive for continuous improvement.

Our board

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

We would like to say thank you and farewell to Catherine Bell who will be standing down at the company's general meeting in July, after nine years on the board. Catherine is chair of the corporate responsibility committee and a member of the nomination, audit and remuneration committees and has provided invaluable guidance to United Utilities throughout her time on the board.

We are pleased to welcome Alison Goligher to the board with effect from 1 August 2016. Alison's industrial and engineering background from her roles with Royal Dutch Shell and Schlumberger will be a great asset to the board.

Outlook

We are confident that we can build on our strong operational and environmental performance and improve further as we progress through this new regulatory period, supported by our 'systems thinking' approach to operating the business. We are accelerating our 2015–20 capex programme and substantial investment in our assets will continue, driving benefits for our customers and the environment. Our progress over the first year of this new regulatory period underpins our confidence in delivering our targets. For shareholders, we are targeting dividend growth of at least RPI inflation each year through to 2020, all underpinned by a robust capital structure.

Dr John McAdam
Chairman

Steve Mogford
Chief Executive Officer

The strategic report on pages 4 to 49 was approved at a meeting of the board on 25 May 2016 and signed off on its behalf by Steve Mogford, Chief Executive Officer.

How we create value within our operating environment

Our industry and market

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

We are the second largest of these based on the size of our asset base, as measured by Regulatory Capital Value (RCV). We, along with these other nine companies, comprise the vast majority of the total water and wastewater sector, as depicted on the pie chart below.

Additionally, there are licensed companies which provide water-only services and tend to be smaller in size.

As each company in the water sector operates as a regional monopoly for its services, they are subject to regulation in terms of both price and performance.

The privatisation of the industry over two decades ago has been widely perceived as a success, making a significant contribution to public health. It has led to improvements in the quality of services provided to customers, higher environmental standards and superior quality drinking water at lower estimated costs to customers than if the water sector was still owned by the UK Government. Since privatisation, the water industry has invested over £100 billion in maintaining and improving assets and services.

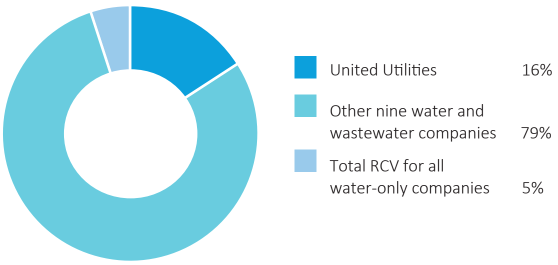
Competitive environment

The other water companies in England and Wales are naturally our main competitors and we benchmark our performance against them using comparative performance reports from our economic regulator, Ofwat, and our environmental regulator, the Environment Agency. Away from the water sector, in line with our vision to be the best UK water and wastewater company, we also benchmark our customer service performance against other leading service providers in our region. In addition, as a publicly listed FTSE 100 company, the other UK and worldwide listed utilities are competitors from an investment perspective.

The customers we serve

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

Water sector RCV



Our vision

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

Over the last five years we have made significant progress towards our vision, having achieved industry-leading status on many performance metrics used by our regulators and other stakeholders. We realise, however, that we have more to do and that the environment in which we operate is changing – adding to both the challenge and opportunity.

We were one of the most improved companies in our sector for customer satisfaction over the last regulatory period and underlying performance last year showed another year on year improvement. Our ambition is to be highly regarded by the customers we serve and so, in addition to water sector measures, we regularly rank customer perception of our performance against other leading brands operating in the North West. We score well in this survey, just behind the well-regarded brands of John Lewis and Marks and Spencer. What is clear is that customer expectations are ever increasing. Improvements since privatisation mean that water supply interruption is very much the exception and customers' expectation of compensation for service failure is growing. Our service proposition must adapt accordingly and we are investing in a complete overhaul of our day to day customer service proposition to provide customers with a best-in-class offering. In addition, the incidents we experienced last year showed us that there is more we can do to help customers at difficult times in their lives and in May 2016 we launched our 'Priority Services' offering to provide targeted support to customers who are experiencing short or long term difficulty.

The 2015 storms in the North West demonstrated the importance of infrastructure resilience and the ability to minimise the impact of severe weather events. Climate change predictions indicate that we can expect more frequent periods of intense rainfall and drought across the UK. Whilst it is impractical to believe we can protect customers fully from the implications of climate change, we can take measures aimed at reducing the impact of weather events and enabling recovery to be as fast as possible. Over recent years, we have invested significantly in enhancing the resilience of our systems and this proved to be of considerable benefit during last year's events. Our plans over this five year regulatory period include investment in enhanced resilience. Water companies are currently working with other stakeholders, including Defra, our regulators and leading research establishments, to consider what additional measures we can take both individually and collectively to enhance our resilience to climate change. We are playing an active role in this dialogue.

In order to deliver our vision, we will need to continue to make significant improvements in our operational efficiency. We have looked for best practice inside and outside our sector and we are progressively transforming our operating model using what we call 'systems thinking'. For water, our philosophy is to consider our landscape of reservoirs, aqueducts, process sites and distribution networks as a 'big system' and to use processes and technology to deliver uninterrupted, wholesome water to customers at lowest cost. It means changing the culture of our organisation from reactive to proactive, finding and fixing problems before they affect our services to customers. A recent example is our Thirlmere pipeline project where our integrated approach enabled us to consider a wide range of factors in determining what we believe to be the best solution for customers, shareholders, local communities and the environment. The project is designed to protect the environment as well as providing long-term resilience of water supplies in West Cumbria.

On wastewater, we are currently piloting the integration of our assets across a full drainage area to understand how we can improve our response to weather and customer activity. Through this work we are seeking to develop systems to optimise the performance of our wastewater network in different conditions, to benefit environmental outcomes, energy generation from renewables and reduce operating cost. Our first 'systems thinking' investment was delivered towards the end of the last regulatory period with the opening of our new integrated control centre and more capability will be delivered over the next 18 months. Our plans for the next regulatory period are currently being developed, taking learning from using the capability in this period and looking to exploit falling sensor costs and developments in artificial intelligence.

Our vision recognises that the market in which we operate is changing. The Water Act 2014 introduced the potential for wide ranging change, commencing with the opening of the non-household retail market to competition in April 2017. The UK Government recently asked our economic regulator, Ofwat, to consider the merits of opening the household retail market to competition and Ofwat will present its conclusions later this year. In addition, under a strategy of progressive evolution of the water market, Ofwat declared its intent to open the market for water resources and sludge processing to competition from 2020.

These developments represent the most significant structural change for the water sector since privatisation and we are working constructively with the government and our regulators to understand the implications for customers and shareholders and offer solutions for their effective implementation. We will continue to put effort into being competition ready as is evidenced by our recent move in forming a joint venture with Severn Trent for the non-household retail market, building on our successful entry into the Scottish market and our investment in new systems to provide an enhanced offering to business customers.

How we create value

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

This is represented in the diagram on the next page, with the subsequent pages of this report mapping to its colour-coded sections.

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

'Systems thinking' lies at the heart of our day-to-day decision making, right through from approving our capital expenditure programmes to agreeing our supply-chain partners. Whilst the financial impact is a key driver in decision-making, this is always set in the context of the impact on customers, shareholders, the environment, employees and communities. For many years we have included corporate responsibility (CR) factors as strategic consideration, supported by our CR committee which is chaired by one of our non-executive directors (more details are provided in the corporate governance section on pages 80 to 81).

We are committed to delivering our services in a responsible way and our approach to responsible business practice is outlined in our Business Principles document available on our website at corporate.unitedutilities.com/united-utilities-business-principles

Pictured opposite: Our new £200 million extension to Liverpool wastewater treatment works had its official opening in April 2016 when Her Royal Highness the Princess Royal visited our Sandon Dock site (read the full story on page 38). As part of the development of the site, a new Sequencing Batch Reactor (SBR) treatment facility has been built, capable of cleaning 11,000 litres of wastewater every second, serving 600,000 people.

How we create value within our operating environment
Our business model

External Environment
Natural · Economic · Technological · Political and Regulatory · Social

Internal Environment
Governance · Culture

Key Resources

Natural Resources
- Water
- Waste
- Catchment land

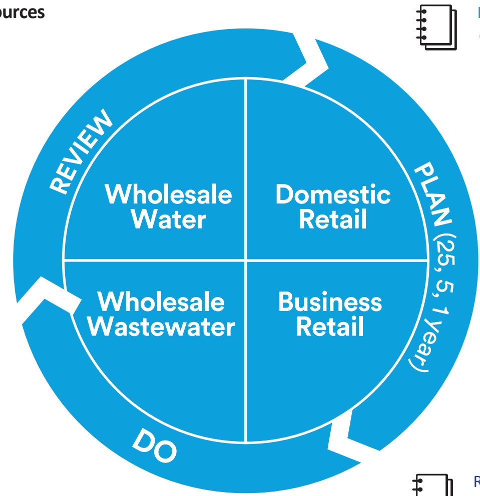
People
- Employees
- Suppliers
- Relationships
- Capability

Assets
- Reservoirs
- Treatment works
- Networks
- Systems

Financing
- Debt
- Equity

Read more on **Key Resources** on pages **13** to **15**

Read more on **Planning** on pages **23** to **25**



Read more on **External Environment** on pages **17** to **20**

Read more on **Internal Environment** on page **21**

Outcomes

The best service to customers
Provide great water
Dispose of wastewater
Deliver a service customers can rely on

At the lowest sustainable cost
Value for money
Improved efficiency

In a responsible manner
Protect and enhance environment
Support local communities
Support employees in safe workplace

Read more on **Outcomes** on page **26**

Provide an appropriate risk and return for investors

Read more on **Risks** on pages **46** to **49**

How we measure our performance KPIs

Wholesale ODIs
SIM - qualitative
SIM - quantitative
Business retail customer growth

Totex outperformance
Financing outperformance
Domestic retail cost to serve

Leakage
EA performance assessment
Dow Jones Sustainability Index

Read more on **KPIs** on pages **28** to **29**

Key resources

Natural resources

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

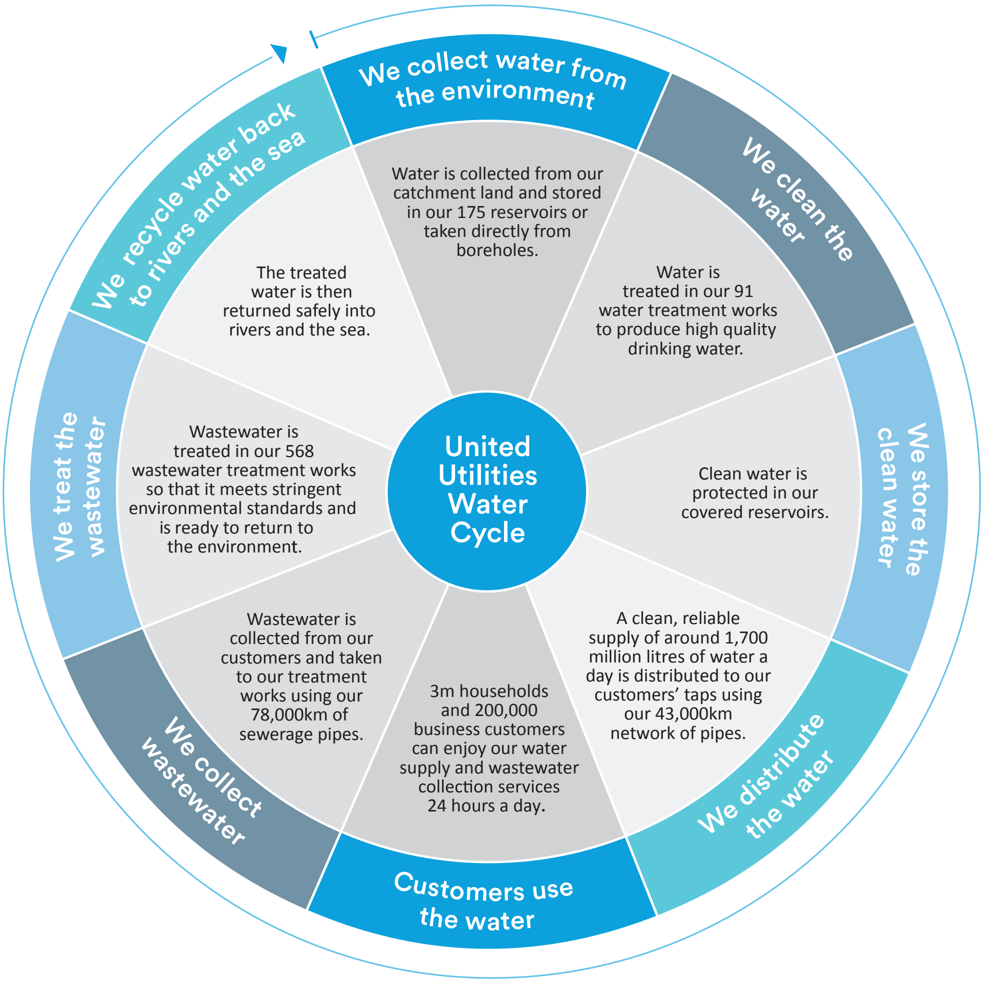
We own over 55,000 hectares of land around our reservoirs. Our sustainable catchment management programme (SCAMP) has shown that we can effectively manage these catchments to protect and enhance water quality and to provide other benefits such as an improved natural environment. Our new Catchment Wise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

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

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

What we do – our water cycle

We collect water from the environment, clean it and distribute it to our customers before collecting it, treating it, and then returning it back to the environment.



How we create value within our operating environment

People

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

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

All of our employees are paid at least the Living Wage as defined by Living Wage Foundation and independent studies have shown that this enhances the quality of work of staff, increases staff retention, reduces absenteeism as well as providing societal benefits. Management has a range of incentives which focus on performance over a number of years, rather than just the current year, to encourage the delivery of benefits over the longer term.

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

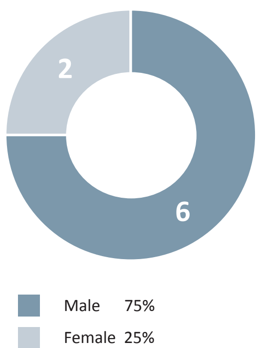
We value diversity, providing equality of opportunity and recruiting and promoting on merit, which we believe provides the benefits of a more comprehensive and balanced skills-set. Despite being a highly engineering-based organisation, women are represented at all levels of our company, with one-third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

The health and safety of our employees is fundamental, most importantly to the welfare of our employees but also to the reputation and performance of our company. This continues to be a significant area of focus as we strive for continuous improvement We have implemented a number of initiatives over recent years which have helped to reduce the employee accident frequency rate, as detailed on page 38.

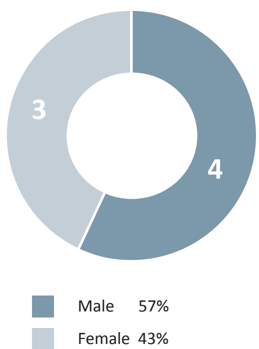
Our suppliers and contractors provide us with essential services which we rely on to deliver our strategy and we work with those whose business principles, conduct and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, further supporting the delivery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

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

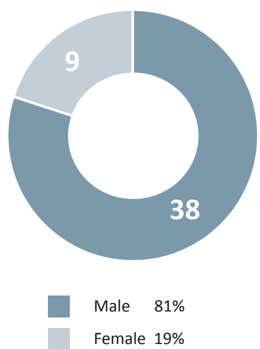
Group board



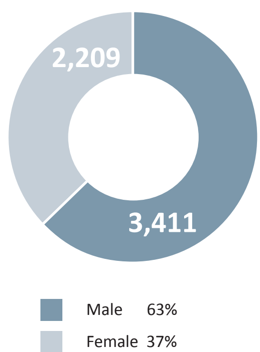
Executive team*



Senior managers



Wider employees



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

Note:
There are 13 male (81 per cent) and 3 female (19 per cent) employees who are appointed as statutory directors of subsidiary group companies but who do not fulfil the Companies Act 2006 definition of 'senior managers'.

Assets

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

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

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

We expect to invest around £3.5 billion across 2015–20 and to continue with a substantial investment programme for the foreseeable future in order to meet more stringent environmental standards from the European Union and to maintain and improve the current standards of our assets and services. When deciding on our investment strategy we have to be mindful of the impact on our customers' bills and this is why, for example, we are spreading some of the environmental spend required by European legislation over the next 15 years.

Pictured right: Stakeholder manager Steve Wong, alongside our new outfall pipe in Blackpool. The 2,000 tonne, one kilometre long pipe acts as a release valve when the sewer system reaches its maximum capacity when, for example, there is extremely heavy rainfall. The new pipe, which took a week to arrive in Blackpool from Norway, is part of our £125 million investment programme along the Fylde coast to improve the existing sewer network.

Financing

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

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

Pictured right: The European Investment Bank is our largest lender with over £2.0 billion of debt and undrawn facilities, including a new £250 million loan signed in April 2016.

European Investment Bank

How we create value within our operating environment

Business Insight

Investing in resilient services

Any provider of essential utility services, such as water, has to be prepared for 'shocks' to the system, such as extreme weather events. Responsible service providers prepare on two fronts – first they invest in their assets so, as far as possible, they continue to provide services to customers when the shocks occur but, secondly, if those services are interrupted, robust contingency plans exist to restore normal operation as soon as possible.

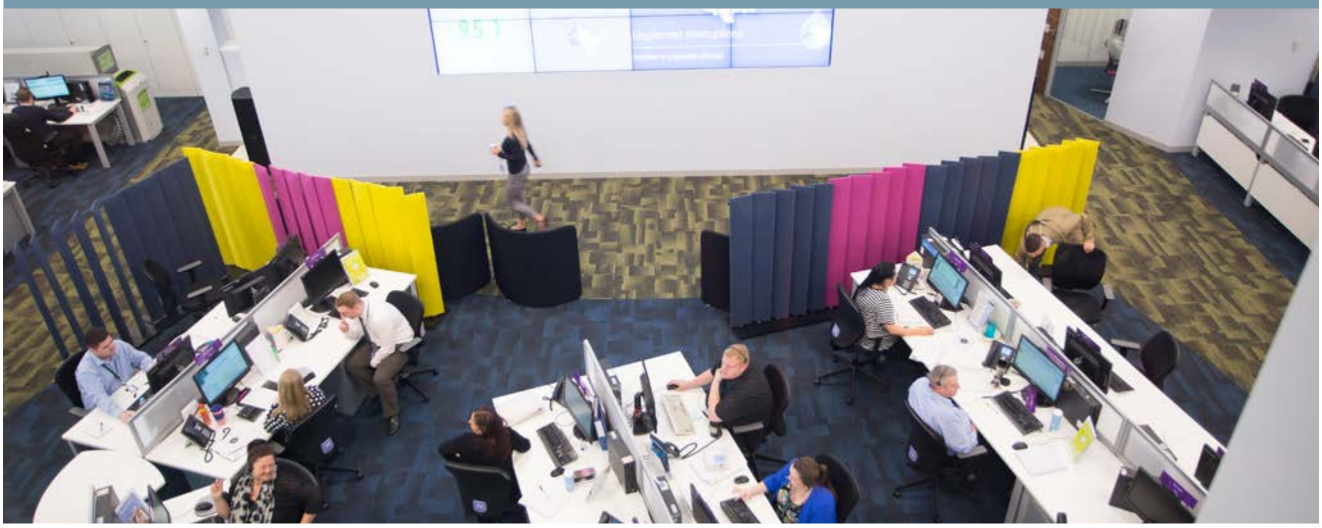
This approach has characterised the company s planning for resilience and is illustrated by specific investment projects from AMP5. For example, between 2010 and 2015, 30 cross-connections linking parts of the water network together were installed to give greater flexibility to move water around. At a larger scale, the £150 million West-East pipeline between Manchester and Liverpool was completed, allowing water from Wales to supply Manchester and supplies from the Lake District to reach Liverpool, further integrating the water network to improve its resilience.

This planning has extended to water quality. As well as supplying Manchester, the Haweswater aqueduct delivers water to places such as Accrington and Burnley. Ultraviolet equipment has been installed where these supplies are taken, improving treatment capability and reducing the risk of water quality problems such as cryptosporidium. When raw water quality, sourced from reservoirs, boreholes and rivers, is affected in some way, we have piloted new operational practices to ensure that when the water treatment works first starts up again, this water does not enter the distribution network.

As we moved from AMP5 to AMP6, we opened the new digital' brain of our operation, the Integrated Control Centre (the ICC, pictured below). As well as delivering customer service benefits, the capabilities now available in the ICC help us provide more resilient services. For example, we can now better manage the movement of water supplies across the region, balancing where that water is available with the lowest cost of providing that water, ensuring we balance our stocks and keep pressure off customer bills.

Investment in asset resilience will continue to 2020 and beyond. We will invest in excess of £15 million to protect water quality within our service reservoirs. The pilot at water treatment works, to better manage water when works first start up, will be extended across the region. In Cumbria, our £300 million project to link the west of the county to the regional supply network, scheduled for completion in 2022, will provide more resilient supplies to over 150,000 people.

As we begin planning for the AMP7 investment period, from 2020 to 2025, our approach will remain unchanged as planning to deliver a resilient service is embedded in what we do. Maintenance work is planned on the Haweswater aqueduct following its first inspection in over 50 years in 2013. In addition, we will continue to build climate change projections into our wastewater modelling and water resource management plans to understand better possible future 'shocks'. Once a comprehensive review of the resilience of our assets is complete, which takes into account the experiences of the 2015 winter floods, we will develop the next iteration of our asset resilience programme.



External environment

Natural

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

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

We must tackle flooding incidents caused by the intensive bursts of rainfall which are becoming more frequent due to changing weather patterns. This was evident in December 2015, when Honister in Cumbria broke existing UK records for the most rainfall over a 24-hour period, with the consequential devastating flooding across the region. More details on the flooding incidents in December 2015 and how we responded are shown in the business insight on page 35.

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

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

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

Economic

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

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

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

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

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

How we create value within our operating environment

Business Insight

Systems thinking

Underpinning our improving operational performance is our drive toward 'systems thinking' based on four key themes:

- improving the reliability of our assets with the object of reducing unplanned, and therefore costly, service interruptions;
- improved use of data at local asset level and centrally for performance optimisation;
- adopting a systems approach to our regional water system and wastewater drainage areas to optimise cost and service performance; and
- resource allocation to production teams with full accountability for asset and system performance.

We are investing in this regulatory period in our new wholesale operating model and are progressing rolling out of this radically different capability. Our production line model is well established and last April we opened our new integrated control centre (ICC). This is increasingly becoming a central hub for planning and control of our operations and proved to be a tremendous asset during our handling of the major incidents we had to address last year.

Our new telemetry backbone has been successfully installed across our estate with only a small number of sites to complete. This provides the 'data highway' between our sites and the ICC, enabling enhanced monitoring and intervention.

We have full regional production planning up and running for both water production and sludge processing, supported by more enhanced decision-making systems capability at site level.

We are in the final stages of testing of our new maintenance system, providing more effective tasking of field engineering. We have also improved asset availability.

And, we are also using more sensors in our network and better analysing other data, such as weather forecasting, to help reduce costs and improve operational performance and, importantly, prevent issues before they impact the customer.

This is all supported by our digital strategy in which we have already seen our IT systems overhauled and for which data and its exploitation becomes central to our thinking.

Our 'systems thinking' approach is expected to deliver benefits of over £100 million across the 2015-20 regulatory period, which were already built into our business plan assumptions.

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

Read more on **Principal risks** on pages **46** to **49**

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

Technological

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

Read more on this approach in our **Business insight** in the column on the left

We have also been utilising technology within our energy self-generation. For example, our Davyhulme sludge recycling centre employs a ground-breaking configuration of thermal hydrolysis to maximise energy generation from sludge and won an Annual Institute of Chemical Engineers award for innovation in 2013/14. During 2015/16, we built Europe's largest floating solar array system on our Godley reservoir, more details of which are shown within our business insight on page 37.

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

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

Read more on **Principal risks** on pages **46** to **49**

Political and regulatory

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

Economic regulation

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

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

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

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

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

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

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

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

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

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

Read more online at
www.ofwat.gov.uk

Changes in regulation opening up the competitive arena

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

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

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

How we create value within our operating environment

Environmental and quality regulation

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

Defra is the UK Government department responsible for water policy and regulations in England and Wales; it also sets drinking water quality and environmental standards (many based on European law) which water companies must meet. **www.gov.uk/defra**

The Environment Agency controls how much water can be drawn from the environment and the quality of water returned to rivers and the sea. The EA produces an assessment of water and wastewater companies' annual performance, and we include this as one of our KPIs, see page 29. **www.gov.uk/government/organisations/environment-agency**

The Drinking Water Inspectorate is responsible for ensuring compliance with the drinking water quality regulations. **www.dwi.gov.uk**

Natural England is responsible for the protection of designated sites for nature conservation, for example Sites of Special Scientific Interest. Companies are required to manage these sites and to protect and enhance biodiversity. **www.naturalengland.org.uk**

The Consumer Council for Water (CCW) represents customers' interests relating to price, service and value for money. It also investigates customer complaints. Customers who remain dissatisfied can refer their complaint to be adjudicated by an independent service, WATRS (see below). **www.ccwater.org.uk**

WATRS is an independent service designed to adjudicate disputes that have not been resolved through the water company's customer service teams or by referring the matter to the Consumer Council for Water. **www.watrs.org**

Social

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

Read more on **Technological external environment** on page **18**

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

Pictured: Outreach manager Carole Quinn (right) from United Utilities and Moira Osborne from Age UK Rochdale help to promote our new social tariff (entitled 'Help to Pay'). The scheme caps water bills for low income pensioners who may be struggling to pay their water bill and our partnership with Age UK Rochdale is helping to increase awareness of our social tariff directly to those customers who will benefit from this scheme.

Internal environment

Governance

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

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

An important risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our financeability, and that they are agreed by Ofwat in its final determination, as we are bound by these plans for the following five-year period with limited opportunity to change them. See pages 46 to 49 for more details on what we consider to be our top risks.

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

The governance section of the annual report on pages 50 to 109 presents information on the board of United Utilities and its activities and those of the various board committees. It also sets out how the board demonstrates leadership, effectiveness and its accountability to the company's stakeholders.

Culture

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

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

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

How we create value within our operating environment

Our business model

In line with Ofwat's evolution from one single price control to four (see political and regulatory environment on page 19), we have structured our business into four distinct areas: Wholesale water; Wholesale wastewater; Domestic retail; and Business retail.

Each business area undertakes both long-term and shorter-term planning to identify how it can best deliver its outcomes. We adopt an integrated approach which considers a whole range of stakeholders including customers, investors, the environment, our employees and local communities. These plans also take into account the internal and external factors described on pages 17 to 21. Underpinning our approach to planning, we undertake a cycle of continuous assessment using KPIs and other performance measures which helps formulate future plans, with a view to delivering further improvements for our various stakeholders.

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

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

What we aim to do:

2016 – We will adopt all private pumping stations

2017 – We will be ready when full retail competition for business customers is introduced

2020 – Over 90% of meters will be automatically read

We will reduce by more than 40% the number of properties flooded internally by sewage

2020+ – We will continue to improve bathing waters to at least 'sufficient' or 'good' status

2025 – We will extend our integrated water supply network into West Cumbria

Planning

Planning – 25 years+

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

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

– climate change and its implications for water resources and flooding;

– the emergence of a more open, competitive UK water market;

– more rigorous environmental regulations; and

– the ever-present need to combine affordable bills with a modern, responsive water and wastewater service.

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

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

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

– investing in our people to ensure a committed, capable and motivated workforce which delivers high performance;

– close collaboration with suppliers;

– efficiently implementing a robust and appropriate mix of debt and equity financing;

– disciplined investment, based on a sustainable whole-life cost modelling;

– embracing innovation to make our future services better, faster or cheaper;

– long-term planning and management of water resources – 25-year Water Resource Management Plan;

– responding to climate change; and

– sustainable catchment management.

Planning for future water demand

Our 25-year Water Resource Management Plan sets out the investment needed to ensure that we have sufficient water to continue supplying our customers, taking into account the potential impact of climate change.

Read more online at
unitedutilities.com/waterresourcesplan

2027 We will improve all inland rivers to be at least 'good' status

2030 We will work with others to achieve 'Blue Flag' beaches along our coastline

2040 We will serve 600,000 more households in the North West

We will install 3 million extra water meters covering 76% of households

How we create value within our operating environment

Planning – 5 years

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

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

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

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

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

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

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

Wholesale water

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

Wholesale wastewater

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

– constrain costs associated with taking responsibility for all private sewers and private pumping stations across the region, through improvements to our operating model and efficient delivery of our programme.

Domestic retail

– continue to improve the customer experience by being more proactive with customers, anticipating problems before they materialise and improving our communication channels so that we are easier to do business with;

– reduce further the number of customer complaints and to resolve them whenever we can, avoiding the need for complaints to be referred to the Consumer Council for Water;

– reduce the debt burden on the company and its customers by engaging with those who are struggling to pay, helping them to return to sustained payment behaviour. We are extending our options for assistance to hard-pressed customers, developing a new social tariff from 2015, and we remain committed to contribute annually to the United Utilities Trust Fund, which has proven effective in helping customers in difficulty return to regular payment; and

– reduce the cost to serve our customers through systems and process improvement. This is particularly important under the new price control methodology which uses an industry average retail cost to serve to determine part of customer bills.

Business retail

– build stronger relationships with customers to develop tailored plans to meet their needs;

– give customers greater choice in how they contact and transact with us;

– increase first point resolution and case ownership, reducing cost to serve and improving customer satisfaction;

– install meters in all business customer premises that give automated meter reads (AMR) to facilitate billing for actual consumption; and

– offering value-add additional services such as leakage detection and repair and ways in which to reduce water use.

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

Planning – 1 year

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

At the end of every financial year, our performance is assessed against this basket of measures and this determines employees' annual bonuses right through the organisation. As well as annual targets, our directors are assessed against three-year performance covering total shareholder return, sustainable dividends and customer service through long-term incentive plans. Details of the 2015/16 annual bonus and vested long-term incentive plans for our executive directors are shown on pages 92 and 94 respectively within the remuneration report.

Pictured below: United Utilities key customer manager Jill McGrath with Steve Woods, Environmental and Health & Safety Technologist at Dairy Crest. Our key customer managers play an important role in helping to develop strong relationships with our commercial customers, acting as the first point of contact to resolve any service issues and offer advice around leakage detection and water efficiency.

How we create value within our operating environment

Outcomes

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

The best service to customers

Provide great water

- Drinking water is safe and clean
- Customers have a reliable supply of water now and in the future

Dispose of wastewater

- Wastewater is removed and treated without customers ever noticing
- The risk of sewer flooding for homes and businesses is reduced

Deliver a service customers can rely on

- Customers are highly satisfied with our service
- Customers find it easy to do business with us

Lowest sustainable cost

Give value for money

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

Improve efficiency

- Our services are provided in an increasingly efficient way
- Efficiencies are delivered in a sustainable way taking a long-term view

Responsible manner

Protect and enhance the environment

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

Support local communities

- We invest in community partnerships for mutual benefit
- Our employees make a positive contribution to local communities

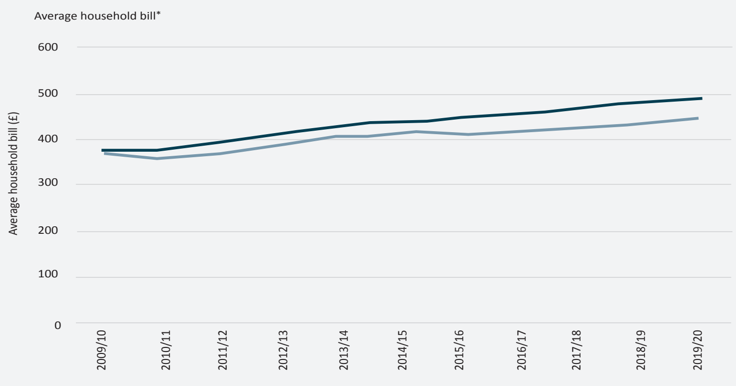
Support employees in a safe workplace

- Provide safe, secure working conditions
- Provide competitive rewards to attract and retain employees
- We invest in the learning and development of our employees

Provide an appropriate risk and return for investors

Outcome: Give value for money customer bills are fair

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



*Assumes 3% p.a. RPI inflation from 2017/18 to 2019/20

Our key performance indicators (KPIs) 2015–20

To help measure our progress on how well we are adding value for our stakeholders and delivering the outcomes described on page 26, we focus on a range of financial and operational KPIs, as defined below. These KPIs are set for the five-year period of our short-term planning horizon and encompass the important areas of customer service and environmental performance, as well as financial indicators, taking into consideration the interests of all of our stakeholders. Strong performance across these KPIs would indicate that our strategy is delivering on our targeted outcomes, helping us on our path to reaching our long-term strategic goals.

Our operational KPIs have evolved to reflect the move to a totex price control for the 2015–20 regulatory period, with a totex outperformance measure replacing the previous separate opex outperformance and capex outperformance measures. We now include an outcome delivery incentive (ODI) KPI in our wholesale business to monitor our performance against these important new operational measures. This replaces the previous serviceability KPI which is incorporated within the ODI measures. With the retail household price control now being separated, we have introduced a new KPI to measure our costs in this area. In the business retail price control, with the expansion of competition, we have included a new KPI measuring the impact of customer gains and losses.

Our financial KPIs are the same as for the previous year except that we will no longer be including capital investment specifically due to Ofwat's move away from opex and capex and into the new totex based price control for 2015–20.

Our executive bonuses and long-term incentives are intrinsically linked to our financial and operational performance KPIs as highlighted in the remuneration report on pages 82 to 101.

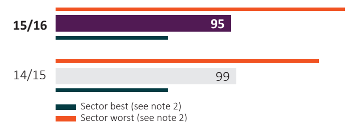
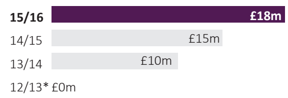
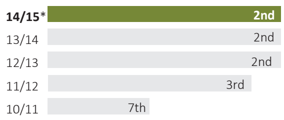
Financial KPIs

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

KPI	Definition	Performance
Revenue	A definition of revenue is included within the 'Accounting policies' note on page 155	**£1,730m +0.6%** 15/16 £1,730m 14/15 £1,720m 13/14 £1,689m 12/13 £1,636m 11/12 £1,565m
Underlying operating profit	The underlying operating profit measure excludes from the reported operating profit any restructuring costs and other significant non-recurring items. The group determines adjusted items in the calculation of its underlying operating profit measure against a framework which considers significance by reference to profit before tax, in addition to other qualitative factors such as whether the item is deemed to be within the normal course of business, its assessed frequency of reoccurrence and its volatility which is either outside the control of management and/or not representative of the current year performance. A reconciliation is shown on page 44	**£604m -9.1%** 15/16 £604m 14/15 £664m 13/14 £635m 12/13 £604m 11/12 £594m
Underlying earnings per share	This measure deducts underlying net finance expense and underlying taxation from underlying operating profit to calculate underlying profit after tax and then divides this by the average number of shares in issuance during the year. 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. Reconciliations to the underlying measures above are shown on page 44	**47.7p -8.1%** 15/16 47.7p 14/15 51.9p 13/14 44.7p 12/13 38.7p 11/12 35.3p
Dividend per share	This measure divides total dividends declared by the average number of shares in issuance during the year	**38.45p +2.0%** 15/16 38.45p 14/15 37.70p 13/14 36.04p 12/13 34.32p 11/12 32.01p
Gearing: net debt to regulatory capital value	Group net debt (including derivatives) divided by UUW's regulatory capital value (Ofwat's published RCV in out-turn prices) Our target range is 55% to 65%	**61% +2.0%** 15/16 61% 14/15 59% 13/14 58% 12/13 60% 11/12 59%

Operational KPIs

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

Company objective/KPI	Definition	Target	Performance
Best service to customers			
Wholesale outcome delivery incentive (ODI) composite	Net reward/(penalty) accrued across United Utilities' 19 wholesale financial ODIs	Range of +£30m to -£70m over 2015–20	**2015/16: £2.5m net reward** ODIs only introduced in 2015/16 so no prior year comparators
Service incentive mechanism – qualitative	Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 18 water companies (previously 19 in 2014/15). Each company receives a score in the range of zero to five, with five being the highest attainable score	To move towards the upper quartile in the medium-term	 New methodology for 2014/15, hence no prior year comparators
Service incentive mechanism – quantitative	Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 18 water companies (previously 19 in 2014/15). Each company receives a SIM point total, where the lowest score represents the best performance	To move towards the upper quartile in the medium-term	 New methodology for 2014/15, hence no prior year comparators
Business retail customer growth	Amount of additional annualised revenue from winning customers from other water retail providers less the amount of revenue lost from losing customers to other water retail providers	See note 1 below	 *Scottish licence granted in 2012/13
Lowest sustainable cost			
Totex outperformance	Progress to date on delivering our promises to customers within the cumulative 2015-20 wholesale totex final determination allowance	To meet Ofwat's final determination totex allowance	**2015–20: On track to meet the final determination allowance** Totex new measure for 2015-20 period hence no prior years' comparators
Financing outperformance	Progress to date on financing expenditure outperformance secured versus Ofwat's industry allowed cost of debt of 2.59 per cent real over the 2015–20 period	To beat Ofwat's industry allowed cost of debt	**2015–20: On track to beat Ofwat allowance** 2010–15: Exceeded £300m target
Domestic retail cost to serve	Cost to serve in our domestic retail business compared with Ofwat's revenue allowance	To minimise costs compared with Ofwat's revenue allowance	**2015/16: £10m outperformance** Domestic retail allowance first introduced by Ofwat for 2015-20 period hence no prior years' comparators
Responsible manner			
Leakage – average annual leakage	Average annual water leakage from our network quantified in megalitres per day	To meet our regulatory leakage target, as set by Ofwat	**2015/16: 463Ml/d - Met target** 2014/15: 454Ml/d – Met target 2013/14: 452Ml/d – Met target 2012/13: 457Ml/d – Met target 2011/12: 453Ml/d – Met target
Environment Agency performance assessment	Composite assessment produced by the Environment Agency, measuring the absolute and relative performance of the 10 water and wastewater companies across a broad range of areas, including pollution	To be a first quartile performer on a consistent basis	 *2014/15 latest available assessment
Dow Jones Sustainability Index rating	Independent rating awarded using sustainability metrics covering economic, environmental, social and governance performance	To retain 'World Class' rating each year	**2015/16: 'World Class'** 2014/15: 'World Class' 2013/14: 'World Class' 2012/13: 'World Class' 2011/12: 'World Class'

Our performance and the progress we have made against our objectives and their associated KPIs are included within the business performance section on pages 30 to 45.

Note 1: No target set due to the proposed joint venture of United Utilities' and Severn Trent's non-household retail businesses.
Note 2: Sector best and worst on quantitative SIM based on datashare of 10/19 water companies for 2014/15 and 13/18 water companies for 2015/16 (based on nine months of actuals).

Our performance 2015/16

Full year results for the year ended 31 March 2016

Continuing operations	Year ended 31 March 2016	Year ended 31 March 2015
Revenue	**£1,730.0m**	£1,720.2m
Underlying operating profit[(1)]	**£604.1m**	£664.3m
Operating profit	**£567.9m**	£653.3m
Total dividend per ordinary share (pence)	**38.45p**	37.70p
RCV gearing[(2)]	**61%**	59%

(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 44.
(2) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's RCV (outturn prices).
(3) Time; Cost; Quality index (TCQi), which is an internal measure of the overall effectiveness of delivery of the capital investment programme (shown below).

Strong operational and environmental performance

– Accelerated investment to deliver early operational benefit; £799 million invested in 2015/16 and TCQi[(3)] at 90 per cent

– £2.5 million net reward achieved for 2015/16 on outcome delivery incentives

– Benefitting from 'systems thinking' operational approach and improved resilience of network

– Retained Dow Jones Sustainability Index 'World Class' rating and sector leading status

Further improvements in customer satisfaction

– Service incentive mechanism score improved compared with last year

– Customers continue to rate us very highly on wastewater services

Implementing efficiency plans to eliminate totex gap

– Business plan initiatives in place to meet totex allowance

– Good progress achieved in first year of the five-year regulatory period

'Water Plus' business retail JV with Severn Trent approved by the CMA

– First mover advantage and economies of scale, ahead of full market opening in 2017

Good financials

– Underlying operating profit down 9 per cent at £604 million, as expected

– Lower underlying net finance expense: benefit of lower cost fixed debt and lower RPI inflation

– Robust capital structure with RCV gearing at 61 per cent, comfortably within our target range of 55 per cent to 65 per cent

– Final dividend of 25.64 pence per share (total for the year 38.45 pence), an increase of 2 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

Best service to customers

Customer service – our continuing strong focus on dealing effectively with customer enquiries has helped us deliver substantial improvements in our performance over recent years and this was recognised by Ofwat in the final determination, with United Utilities averting a possible revenue penalty for the 2015–20 period. This is also reflected in a reduction of approximately 75 per cent in the overall number of customer complaints received over the 2010–15 period, which has also contributed to improvements in opex efficiency.

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

Adjusting for the water quality incident, domestic customer complaints in 2015/16 were lower than last year. Ofwat has amended its SIM methodology for the 2015-20 period, based on domestic retail only and with more emphasis on qualitative performance. This revised methodology is based on a different data set and, as we have highlighted previously, quarterly results may well produce wider fluctuations compared with the last regulatory period. Our SIM scores for 2015/16 have also improved slightly on last year, as outlined in the KPIs section below, despite the operational incidents we experienced in the year.

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

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

Robust water supply – our customers continue to benefit from our robust water supply and demand balance, along with high levels of water supply reliability. We continue to supply a high level of water quality, with an improvement in our water quality index ODI, despite the incident last August, although we did separately incur compensation and other associated costs of around £25 million. We have consistently delivered high quality water and believe this incident was a one-off event for us. We have consistently delivered a reliable water service, although we experienced some water no-supply incidents in 2015/16. Whilst this is disappointing, we have improved internal processes and systems detection capability to help reduce the risk of these incidents occurring in the future. We will also benefit from our integrated control centre, enabling us to take corrective action before the customer is impacted.

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

Ofwat KPIs – our strong overall operational performance is reflected in Ofwat's latest (2014/15) key performance indicators report, which was published in September. The balance of ratings for United Utilities across the 14 assessment measures represents a joint first position, in respect of the 10 water and sewerage companies. We are pleased that our good performance has been recognised, although we remain strongly focused on improving further.

Business retail: 'Water Plus' joint venture with Severn Trent approved by the CMA – we have been building our capability to ensure we are in a strong position as the competitive business retail market evolves and our 'Water Plus' JV with Severn Trent reinforces this position and gives us first mover advantage ahead of full market opening in 2017. 'Water Plus' combines the complementary skills of both companies to deliver an attractive proposition for customers and will create synergies to provide an efficient and cost-effective operation focused on improved customer service and growth. Before the JV, United Utilities was already very active in this expanding market. After attaining a Scottish water supply licence in 2012, we quickly grew to be one of the most successful new entrants in Scotland and we have continued our expansion and have now won approximately 300 customers, covering around 3,500 sites. Overall, our business retail operation has achieved a net increase in annualised revenue of £18 million. We will continue to bid for business at attractive margins and are not solely focusing on growing market share. We also continue to offer and develop our range of value-added services, such as leak detection and water efficiency advice.

Our performance 2015/16

Business Insight

Lancashire water quality incident

In early August 2015, traces of the parasite cryptosporidium were found in drinking water supplies at Franklaw water treatment works, near Preston, which supplies over 300,000 households across Lancashire including Preston, Blackpool and Chorley. To protect public health, we issued a 'boil water advice' to customers, advising they boil their tap water, prior to drinking it, as a precautionary measure.

To eliminate the cryptosporidium, we installed ultraviolet (UV) treatment units at critical points on our network. An asset installation of this size and complexity would normally take several months to complete; however, through working around the clock, we completed the installation in just four weeks. This enabled us to lift the boil water advice in stages with the final one lifted on 6 September 2015.

Clearly, having the boil water advice in place for such a prolonged period caused considerable inconvenience for our customers and we made every effort to keep them fully informed during the incident via leaflets, television interviews, press, social media and our website. We provided bottled water for those customers who needed it most and were unable to boil their water safely. Compensation payments followed quickly to all those customers and businesses affected. Throughout the incident, we maintained regular engagement with key bodies such as Public Health England and local authorities, seeking their advice, input and agreement to our proposed course of action.

At the time of writing, we await the Drinking Water Inspectorate's (DWI) report into this water quality incident. This will set out its view of the cause of the incident and what measures the Inspectorate considers the company should undertake in response, as well as any action it intends to take.

However, we have not waited for the publication of the DWI report before taking action. We have installed permanent UV treatment at Franklaw so that all flow leaving the site is treated with UV. The scale and nature of the incident tested our processes and procedures for vulnerable customers and, applying lessons learned, in May 2016 we launched a new service proposition called 'Priority Services'. This provides an enhanced, holistic service to customers who have needs categorised as: physical, mental health, financial, language and life events.

Pictured: One of the UV rigs arrives at Warbreck in Blackpool. We installed UV rigs at critical points on our network to eliminate cryptosporidium.

Key performance indicators:

Outcome delivery incentives (ODIs) – as outlined at our full year results in May 2015, ODIs, which are a new feature of the 2015–20 regulatory period, will form an important KPI composite to monitor the operational performance of our wholesale business. This replaces the previous serviceability KPI which is incorporated within the ODI measures. There are 19 wholesale financial ODIs and the risk is skewed to the downside, with 10 attracting a penalty only. We will report each year on our performance and provide a net reward or penalty position across the range of our wholesale ODIs.

The impact of the Lancashire water quality incident has not had a material impact on our ODIs, but we have already incurred £25 million of associated costs, as outlined previously. Our sewer flooding ODI is particularly challenging, although there are a number of other areas where we have made a good start, such as private sewers and pollution incidents. Overall, we are encouraged to have achieved a net reward of £2.5 million. We have benefitted from our proactive management approach and the planned acceleration of our investment programme. Our main areas of reward came through our good performance in the areas of private sewers and pollution, with our main penalty being on reliable water service where we experienced some no supply events in the year.

Whilst this overall outcome was better than our initial expectations, the ODI targets get tougher as we move through the five-year regulatory period. Therefore, we need to make further improvements to avoid penalties and this will be very challenging for us. Nonetheless, our progress this year gives us the confidence to improve our target to reflect a cumulative net ODI outcome over the 2015–20 period of between plus £30 million and minus £70 million.

Service incentive mechanism (SIM) – United Utilities was the most improved company on SIM during the 2010–15 regulatory period, although we recognise that there is still more to do. Our target is to move towards the upper quartile in the medium-term.

Qualitative: Ofwat has now undertaken the four surveys for 2015/16 and United Utilities has improved its score to 4.27 points, compared with 4.24 points in 2014/15, despite the Lancashire water quality incident and the unprecedented flooding events. In particular, customers scored us highly for our wastewater service. For 2015/16, United Utilities was in 12th position out of the 18 water companies.

Quantitative: the quantitative assessment measures customer contacts and performance is assessed on both an absolute and relative basis. Relative performance can only be assessed following the end of each full financial year when the other companies publish their respective results. On absolute performance for 2015/16, our score of 95 points represents a slight improvement on the previous year when we scored 99 points.

Business customer retail growth – Ofwat introduced a separate price control for business retail for the 2015–20 period and, with the expansion of competition, we have included a new KPI measuring the impact of customer gains and losses. Our business retail operation has now achieved a net increase in annualised revenue of £18 million. This represents a steady increase from £15 million in 2014/15 and £10 million in 2013/14. However, due to the joint venture between United Utilities and Severn Trent, which has now received CMA approval, we are not setting targets as we are reassessing the appropriateness of this KPI for future reporting.

Our performance 2015/16

Lowest sustainable cost

Power and chemicals – our asset optimisation programme continues to provide the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power assets to generate renewable energy. Supplementing the electricity we generate from sludge, we are developing other renewable energy facilities, principally in the area of solar, where we expect to invest over £100 million across the 2015–20 period of which £32 million was invested in 2015/16. We have also substantially locked in our power commodity costs across 2015–20, providing greater cost certainty for the regulatory period.

Proactive network management – as part of our 'systems thinking' approach to the way we run our business, we are being more proactive in the management of our assets and networks. We aim to improve our modelling and forecasting to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving efficiency.

Debt collection – our region suffers from high levels of income deprivation and we offer wide-ranging schemes to help customers struggling to pay, including our trust fund into which we paid a £6 million contribution in 2015/16. Notwithstanding our industry-leading debt management processes, deprivation remains the principal driver of our higher than average bad debt and cost to serve and we expect this to continue to be a challenging area for us.

In 2015/16, we have reduced bad debt expense to 2.3 per cent of regulated revenue from 3.1 per cent last year. This reflects our ongoing strong focus on managing bad debts, along with a reduction in certain charges, related to our review last year of operational debt processes and bad debt provisions, which were not expected to continue at the same level.

Pensions – United Utilities has taken progressive steps to de-risk its pension provision. The group had an IFRS retirement benefit surplus of £275 million as at 31 March 2016, an increase in surplus from £79 million as at 31 March 2015. Further details of the group's pension provision are provided in the pensions section on page 43.

Capital delivery and regulatory commitments – the business is strongly focused on delivering its commitments efficiently and on time and has a robust commercial capital delivery framework in place. To improve efficiency further, we implemented new contracting arrangements for the 2015–20 regulatory period to help deliver our regulatory capital investment programme of over £3.5 billion. We re-tendered our engineering and construction partners and selected a single engineering partner and four new design and construction partners. We are involving our partners much earlier in project definition and packaging projects by type, geography and timing to deliver efficiencies. Projects will be allocated to partners on an incentive basis or competed between the partners and, where appropriate, third parties. Our partners have come forward with a range of solutions, innovations and pricing and early results are encouraging.

We also continue to drive more effective and efficient delivery of our capital programme and, for this regulatory period, we are applying a tougher measurement mechanism to our Time: Cost: Quality index (TCQi) score. This includes extending coverage to relevant non-regulatory commitments, measuring cost in terms of totex (previously capex only) and giving a greater weighting in the cost element to our biggest capital projects. This has resulted in a recalibration of the index. Despite this tougher approach, our TCQi score remains high at 90 per cent which represents a very good performance above our internal target of 84 per cent for the first year of this regulatory period.

We have made a good start to the 2015–20 investment programme and, as planned, are accelerating the five-year programme to maintain and improve services for customers and deliver early operational and environmental benefits. Regulatory capital investment in 2015/16, including £169 million of infrastructure renewals expenditure, was £799 million, in line with our expectations.

Pictured: One of the concrete access shafts constructed as part of a major £6.5 million sewer project in Manchester city centre. A section of the Mancunian Way carriageway collapsed in August 2015 after heavy rainfall caused a sink-hole to open up on the busy Manchester road, damaging the brick-built Victorian sewer located underneath. The concrete shafts were constructed to allow tunnelling machinery access to build the replacement sewer underneath the carriageway.

Business Insight

Flooding and resilience

In December 2015, the UK was battered by a succession of storms known as Desmond, Eva and Frank. These storms were particularly severe in the North West causing widespread flooding in Cumbria, Lancashire and Greater Manchester.

Our services were also badly affected. Following storm Desmond, water supplies to Keswick were interrupted when its treatment works was inundated with flood water (pictured below) and several large wastewater treatment works were heavily flooded and operations impacted severely. A key route linking north and south Cumbria – the A591 – was badly damaged where it runs on our catchment land alongside Thirlmere reservoir.

Work continues to repair the flood damage and improve asset protection should similar events reoccur. To date, the floods have cost the company around £19.5 million restoring operations, repairing plant and machinery and writing off assets. For example, at Kendal both primary and secondary treatment was lost and the outfall returning treated water to the river was washed away. Initial repair work is now largely complete and, where we can, we have replaced damaged assets in a way to be more resilient to future flooding.

We have been keeping all interested groups updated on our progress, providing support for local recovery groups such as those repairing the damage to the A591. Local managers are actively reviewing the resilience of their assets, assessing risks and compiling actions for mitigation, such as reviewing procedures when amber flood warnings are given.

Alongside this immediate response, we are working with key stakeholders to improve resilience to future flooding risk. We are members of the Cumbrian Flood Partnership that, amongst other things, is considering what flood defence improvements may be needed such as upstream catchment actions to reduce the intensity of water flows at peak times. In addition, we are engaging with the Government s National Flood Resilience Review which will assess how the country can be better protected from future flooding and increasingly extreme weather events.

We are also closely examining our own plans on resilience. We are building upon AMP5 flooding assessments to understand better the consequences of failure from extreme or coinciding events, including environmental and financial impacts, and developing solutions to mitigate risk from extreme events.

Our performance 2015/16

Key performance indicators:

Financing outperformance – The low cost of debt we have already locked-in places United Utilities in a strong position to deliver our target for the 2015–20 period of beating Ofwat's industry allowed cost of debt.

Total expenditure (totex) outperformance – our KPIs have evolved to reflect the move by Ofwat to a totex price control, with totex outperformance for our wholesale business now replacing the previous separate opex outperformance and capex outperformance measures. We exceeded our 2010–15 outperformance targets for both opex and capex. Although our totex allowance is tough, we are implementing a range of initiatives and are confident of meeting our target of delivering our promises to customers within the cumulative 2015–20 wholesale totex final determination allowance. Progress in the first year has been good and we are on track to meet the five-year target.

Domestic retail cost to serve – with the retail household price control now being separated for the 2015–20 period, we are introducing a new KPI to measure our costs in this area. Overall, it will be very challenging to meet the regulatory assumptions for domestic retail costs. This is primarily due to Ofwat's price review methodology at PR14 which made no allowance for inflation in the domestic retail business and, in our view, made insufficient allowance for dual service (water and wastewater) companies. The regulatory assumptions for domestic retail costs become progressively tougher as we move through the 2015–20 period. Our target is to minimise our costs compared with Ofwat's revenue allowance. We have delivered a good performance in 2015/16 and outperformed this year's revenue allowance by around £10 million.

Pictured: Engineers at our Davyhulme wastewater treatment works in Manchester have taken delivery of a fleet of electric vehicles which run on power generated by the plant itself in an effort to cut carbon emissions at the works – one of the biggest sewage plants in the UK.

The new electric 'Polaris' vehicles are replacements for five diesel vans, helping to save around five tonnes of carbon a year. Each vehicle charges up at its own docking station at Davyhulme's award-winning sludge recycling plant.

Davyhulme wastewater treatment works is our biggest plant and will be energy neutral by 2018, thanks to the electricity generated on-site from the biogas produced by the sludge digestion process.

The biogas is used in five combined heat and power engines to generate renewable electricity – up to 80GWh per year. The electricity is retained on-site and used to power the entire Davyhulme wastewater treatment works process. The amount of renewable energy being generated by the process has helped United Utilities to reduce its overall carbon footprint by 22 per cent since 2005/06.

Responsible manner

Acting responsibly is fundamental to the manner in which we undertake our business and the group has, for many years, included corporate responsibility factors in its strategic decision making. Our environmental and sustainability performance across a broad front has received external recognition. Earlier in the 2015/16 financial year, we retained our 'World Class' rating in the Dow Jones Sustainability Index for the eighth consecutive year, again achieving industry leading performance status in the multi-utility/water sector. Retaining 'World Class' status for this length of time is a significant achievement, particularly as the assessment standards continue to increase and evolve. In addition, at the PwC 2015 Building Public Trust Awards, United Utilities was selected as joint winner for 'Excellence in reporting in the FTSE 100'.

Leakage – strong, year round, operational focus on leakage, alongside our network resilience improvements and the implementation of a range of initiatives, such as active pressure management, enabled us to again meet our leakage target in 2015/16.

Environmental performance – this is a high priority for us and we were again an upper quartile company in the Environment Agency's latest performance metrics, as described in the KPIs section below.

Carbon footprint – we are committed to reducing our carbon footprint and increasing our generation of renewable energy. In 2015/16, our carbon footprint totalled 454,857 tonnes of carbon dioxide equivalent, which is a 22 per cent reduction over the last 10 years (see pages 103 and 104, or visit corporate.unitedutilities.com/cr-environment). Our renewable energy production in 2015/16 was 138 GWh, representing 17 per cent of our electricity consumption in the year. This represents good progress over the last few years, up from c13 per cent in 2012/13. We are already implementing plans to significantly increase self-generation over the next few years, with a target of around 35 per cent of our electricity consumption by 2020, subject to there being sufficient projects with acceptable returns.

Employees – we continue to work hard to engage all of our employees in the transformation of the group's performance. Although employee engagement has fallen slightly from last year, at 75 per cent this continues to demonstrate that our employees have a strong capability to adapt. We remain focused on maintaining high levels of employee engagement.

We have been successful in attracting and retaining people and have continued to expand our apprentice and graduate programmes for 2015/16. We now have a total of 54 graduates and 93 apprentices across the business. Our investment in recruiting graduates and apprentices is already benefitting the company, with 49 of them now having secured permanent roles across our business.

Business Insight

Floating solar array

We have a programme for rolling out solar installations across our sites using our extensive roof areas and redundant land for solar farms. During 2015/16 we completed the installation of what is now one of Europe's largest floating solar array systems on Godley reservoir, just outside Manchester, pictured right. While floating solar has been deployed elsewhere around the world, most notably in Japan, it is a relatively new technology in the UK. The installation at Godley consists of around 12,000 panels, covering 45,000 square metres which is equivalent to the size of six football pitches. This should contribute to keeping our future energy costs down and benefit water bills – good news for both shareholders and customers.

Overall, we plan to invest over £100 million across the 2015–20 regulatory period in our non-regulated energy business, mainly in solar facilities. Subject to good projected returns, we are aiming to double our energy self-generation to around 35 per cent by 2020.

Our performance 2015/16

As part of our health and safety improvement programme, we have implemented a number of initiatives which helped reduce further the employee accident frequency rate to 0.104 accidents per 100,000 hours for 2015/16, compared with a rate of 0.112 in 2014/15, 0.137 in 2013/14 and 0.188 in the previous year, although we recognise that we still have more to do. Health and safety will continue to be a significant area of focus, as we strive for continuous improvement.

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

Key performance indicators:

Leakage – Although leakage is included within our outcome delivery incentives, we intend to continue publishing our leakage position separately, with it being an important measure from a corporate responsibility perspective. We delivered a good performance in 2015/16 and have again met our regulatory leakage target of 463 megalitres per day.

Environmental performance – On the Environment Agency’s latest assessment (2014/15 report), which covers a broad range of operational metrics, United Utilities is again an upper quartile company. Based on our performance across the range of metrics, this indicates we were in joint second position among the 10 water and sewerage companies and aligns with our medium-term goal of being a first quartile company on a consistent basis.

Corporate responsibility – United Utilities has a strong focus on operating in a responsible manner and is the only UK water company to have a ‘World Class’ rating as measured by the Dow Jones Sustainability Index. In 2015/16, we retained our ‘World Class’ rating for the eighth consecutive year and aim to retain this rating again this year.

Business Insight

Royal opening of Liverpool wastewater treatment works

Twenty five years after opening the original wastewater treatment works in Sandon Dock, Liverpool, Her Royal Highness the Princess Royal this year returned to the city to open the £200 million extension to the works, built in the adjacent Wellington Dock.

Funded in part by the European Investment Bank, this new investment is a significant milestone in the clean-up of the River Mersey. An additional treatment stage was needed over and above what the original site was providing, to meet the growing needs of the city.

In the mid-1980s the River Mersey had reached an all-time low and was famously known as one of the dirtiest in Europe. But when Sandon Dock was officially opened in 1991 all that changed. Since then the city s waterfront has flourished and many aquatic species have returned to the river including octopus, salmon, grey seals, large cod and even dolphins and porpoises, evidence that the clean-up of the river is working.

The site’s new Sequencing Batch Reactor (SBR) treatment facility will clean 11,000 litres of wastewater a second, serving some 600,000 people, before returning it to the Mersey. This is the first multi-storey SBR plant and largest in the UK. By stacking in this way, it fits within the limited footprint available at Wellington Dock, minimises the environmental impact on the surrounding area and minimises the impact on the adjacent world heritage site.

We are proud that our investment to date has made an important contribution to the renaissance of the Liverpool waterfront and this new plant is our next step.

Financial performance

Revenue

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

Operating profit

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

Reported operating profit decreased by £85 million, to £568 million, reflecting the fall in underlying operating profit, along with an increase in adjusting items. Adjusting items for 2015/16 included compensation and operating costs, totalling £25 million, in relation to the Lancashire water quality incident in summer 2015. Additionally, there was an £11 million charge relating to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

Also in adjusting items was a net credit of £1 million in relation to the unprecedented flooding incidents which occurred in December 2015. We incurred an £11 million impairment charge on our property, plant and equipment plus £1 million on infrastructure renewals expenditure and £7 million of other operating costs. However, these costs were more than offset by insurance proceeds recognised of £20 million.

Investment income and finance expense

The underlying net finance expense of £201 million was £21 million lower than the last year, mainly due to a lower cost of debt locked-in on the group's nominal debt and the impact of lower RPI inflation on the portion of the group's index-linked debt with an eight month lag. Interest on non index-linked debt of £112 million was £13 million lower than last year, due to the lower rates locked in on our interest rate swaps from 2015, compared with our 2010–15 swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £38 million, compared with a net charge of £47 million last year. As at 31 March 2016, the group had approximately £3.4 billion of index-linked debt at an average real rate of 1.5 per cent.

The lower cost of nominal debt along with the lower RPI inflation charge compared with last year, contributed to the group's average underlying interest rate of 3.4 per cent being lower than the rate of 4.0 per cent for the year ended 31 March 2015.

Reported net finance expense of £219 million was significantly lower than the £317 million expense in 2014/15. This £98 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £105 million loss in 2014/15 to a £26 million loss in 2015/16. The fair value losses in both years were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. The fair value loss in 2014/15 was greater than that in 2015/16, as the decrease in medium-term interest rates was larger in 2014/15. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015–20 financial period.

Profit before tax

Underlying profit before tax was £408 million, £39 million lower than last year, due to the £60 million decrease in underlying operating profit, partly offset by the £21 million decrease in underlying net finance expense. This underlying measure adjusts for the impact of the costs associated with the flooding and water quality incidents and retail business market reform, as outlined in the operating profit section above, and other items such as fair value movements in respect of debt and derivative instruments, as outlined in the underlying profit measures table on page 44. Reported profit before tax increased by £12 million to £354 million, as the increase due to the aforementioned fair value movements was largely offset by a reduction in reported operating profit.

Tax

Consistent with our wider business objectives, we are committed to acting in a responsible manner in relation to our tax affairs. Full details of our tax policies and objectives are set out on page 102.

In 2015/16, we paid corporation tax of £53 million, which represents an effective cash tax rate on underlying profits of 13 per cent, 7 per cent lower than the headline rate of corporation tax of 20 per cent. Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on net capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes net fair value movements on debt and derivative instruments and thereby enables a medium-term cash tax rate forecast. We would expect the average cash tax rate on underlying profits through to the end of the current regulatory period in March 2020 to be around 15 per cent. The key risk to sustaining this rate is any unexpected changes in tax legislation or practice and, as necessary, we would actively engage with the relevant authorities in order to manage this risk.

The current tax charge was £53 million in 2015/16, compared with £57 million in the previous year. In addition, there were current tax credits of £9 million in 2015/16 and £10 million in 2014/15, both following agreement with the UK tax authorities of prior years' tax matters.

Our performance 2015/16

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

The total tax credit for 2015/16 was £44 million as compared to a total tax charge of £70 million for 2014/15, the main difference being the current year deferred tax credit of £112 million relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium-term.

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £130-140 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees such as water abstraction charges.

Profit after tax

Underlying profit after tax of £325 million was £29 million lower than last year, principally reflecting the £39 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £398 million, compared with £271 million in the previous year, as the reduction in underlying profit was more than offset by the £112 million deferred tax credit in 2015/16 associated with the enactment of the reductions in corporation tax plus the £78 million movement in fair value on debt and derivative instruments between the two periods.

Earnings per share

Underlying earnings per share decreased from 51.9 pence to 47.7 pence. This underlying measure is derived from underlying profit after tax. Basic earnings per share increased from 39.8 pence to 58.3 pence, for the same reasons that increased profit after tax.

Dividend per share

The board has proposed a final dividend of 25.64 pence per ordinary share in respect of the year ended 31 March 2016. Taken together with the interim dividend of 12.81 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2015/16 of 38.45 pence. This is an increase of 2.0 per cent, compared with the dividend relating to last year, in line with the group's dividend policy of targeting a growth rate of at least RPI inflation each year through to 2020. The inflationary increase of 2.0 per cent is based on the RPI element included within the allowed regulated revenue increase for the 2015/16 financial year (i.e. the movement in RPI between November 2013 and November 2014).

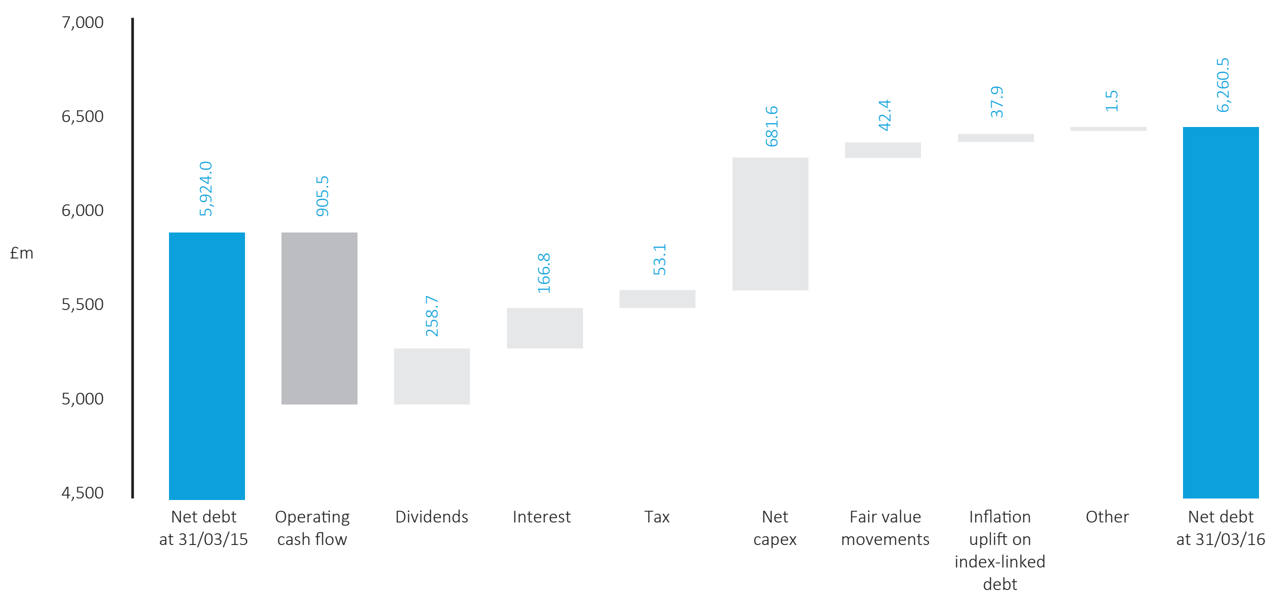
The final dividend is expected to be paid on 1 August 2016 to shareholders on the register at the close of business on 24 June 2016. The ex dividend date is 23 June 2016.

In light of the Financial Reporting Lab's recent report entitled 'Disclosure of dividends – policy and practice' which provided best practice guidance, we have enhanced our dividend policy disclosure as outlined below.

Dividend policy – a growth rate target of at least RPI inflation each year through to 2020.

Policy period – the dividend policy aligns with the five-year regulatory period which runs from 1 April 2015 to 31 March 2020.

Summary of net debt movement



Policy approval process – the dividend policy was considered and approved by the United Utilities Group PLC Board in January 2015, as part of a comprehensive review of the 2015–20 regulatory final determination in the context of a detailed business planning process, with due regard for the group's financial metrics, credit ratings and long-term financial stability, and is reviewed at least annually.

Distributable reserves – as at 31 March 2016, the company had distributable reserves of £3,205 million. The total external dividends relating to the 2015/16 financial year amounted to £262 million. The company distributable reserves support over 12 times this annual dividend.

Financing headroom – supporting the group's cash flow, United Utilities adopts a funding/liquidity headroom policy of having available resources to cover the next 15–24 months of projected cash outflows.

Cash flows from subsidiaries – the directors consider that the group's principal operating subsidiary, United Utilities Water Limited, has sufficient resources to pay dividends to United Utilities Group PLC for the duration of the current dividend policy period to support the external payment of dividends to shareholders.

Financial stability – the water industry has invested significant capital since privatisation in 1989 to improve services for customers and provide environmental benefits, a large part of which is driven by legislation. Water companies have typically raised borrowings to help fund the capital investment programme. Part of total expenditure is additive to the regulatory capital value, or RCV, on which water companies earn a return allowed by the economic regulator, Ofwat. RCV gearing is useful in assessing a company's financial stability in the UK water industry and is one of the key credit metrics that the credit rating agencies focus on. United Utilities has had a relatively stable RCV gearing level over the last five years, always comfortably within its target range of 55 per cent to 65 per cent, supporting a solid A3 credit rating with Moody's. RCV gearing at 31 March 2016 was 61 per cent and the movement in net debt is shown on the previous page.

Dividend sustainability – in approving the policy, the board is satisfied that across the current regulatory period, the projected dividend is adequately covered by underlying profit after tax. Separately, the executive directors' long-term remuneration plan is directly linked to a measure of sustainable dividends. Whilst specific targets are not disclosed in advance, for commercial sensitivity reasons, there is a major focus on the creation of strong earnings that ensure the sustainability of dividends.

Viability statement – the dividend policy is underpinned by the group's long-term viability statement (page 71). Assurance supporting this statement is provided by the review of: the group's key financial measures; the key credit financial metrics; the group's liquidity position; and the contingent liabilities of the group.

Annual dividend approval process – the group places significant emphasis on strong corporate governance and before declaring interim and proposing final dividends, the United Utilities group board undertakes a comprehensive assessment of the group's key financial metrics.

Risks to policy sustainability:

2015–20 – The policy is considered by the board to be robust to reasonable changes in assumptions, such as inflation, opex, capex and interest rates.

Extreme economic, regulatory, political or operational events, which could lead to a significant deterioration in the group's financial metrics during the policy period may present risks to policy sustainability.

2020–25 – A dividend policy for the post 2020 period will be formulated when the outcome of the next regulatory price review is known.

Cash flow

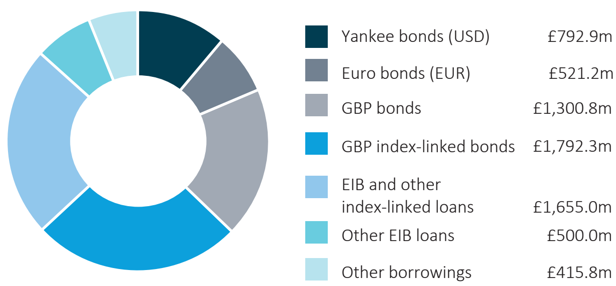
Net cash generated from continuing operating activities for the year ended 31 March 2016 was £686 million, compared with £707 million in the previous year. This reduction mainly reflects lower profit partly offset by an improvement in working capital cash flows and, to a lesser extent, lower corporation tax paid. The group's net capital expenditure was £682 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS.

Net debt including derivatives at 31 March 2016 was £6,261 million, compared with £5,924 million at 31 March 2015. This increase reflects regulatory capital expenditure and payments of dividends, interest and tax, partly offset by operating cash flows.

Fair value of debt

The group's gross borrowings at 31 March 2016 had a carrying value of £6,978 million. The fair value of these borrowings was £7,461 million. This £483 million difference principally reflects the significant fall in real interest rates, compared with the rates at the time we raised our index-linked debt. This difference has decreased from £705 million at 31 March 2015 due primarily to an increase in credit spreads.

Gross debt – total carrying value £6,978.0m



Our performance 2015/16

Debt financing and interest rate management

Gearing (measured as group net debt divided by UUW's regulatory capital value) was 61 per cent at 31 March 2016, an increase of 2 per cent compared with the position at 31 March 2015, remaining comfortably within our target range of 55 per cent to 65 per cent.

UUW has long-term credit ratings of A3/BBB+ and United Utilities PLC has long-term credit ratings of Baa1/BBB- from Moody's Investors Service (Moody's) and Standard & Poor's (S&P) Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. Moody's has the group's ratings on a stable outlook, whereas S&P has the group's ratings on a positive outlook.

The group has access to the international debt capital markets through its €7 billion euro medium-term note programme (EMTN). The EMTN programme does not represent a funding commitment, with funding dependent on the successful issue of the notes.

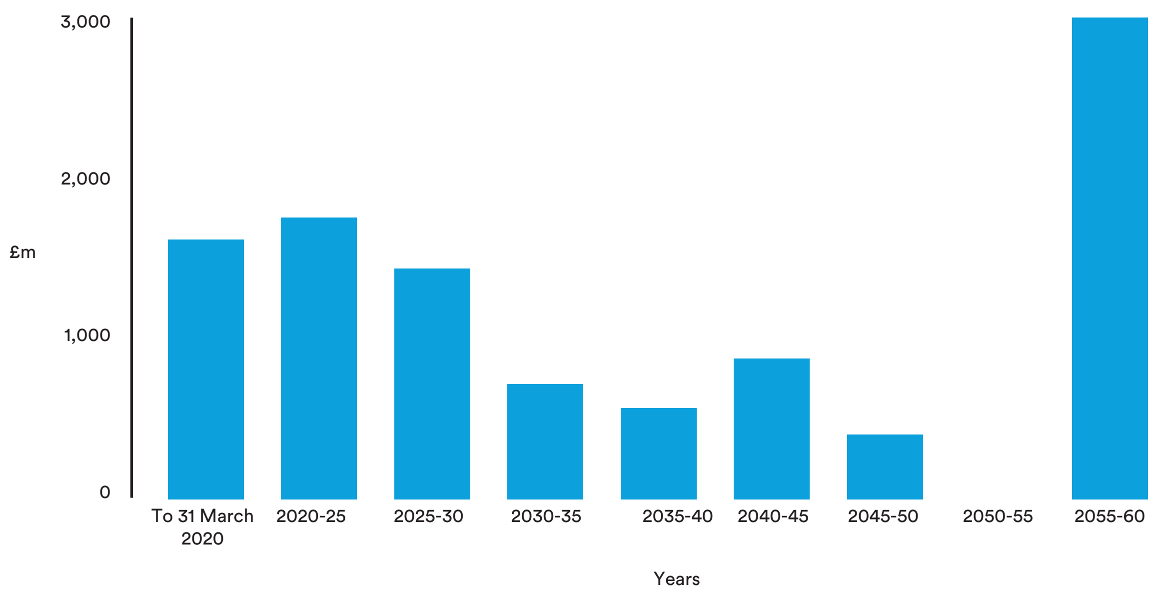
Cash and short-term deposits at 31 March 2016 amounted to £214 million. Over 2015–20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our 2015–20 investment programme and we have now already raised around £1.4 billion of this requirement (including the most recent £250 million loan with the European Investment Bank (EIB), signed in April 2016). In December 2013, UUW agreed a new £500 million term loan facility with the EIB and we drew down the final £150 million on this facility during the first half of 2015/16, all on a floating rate basis. In March 2015, UUW signed a new £250 million index-linked term loan facility with the EIB. This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and as at 31 March 2016 we had drawn down £175 million on this facility. In March 2015, UUW arranged a £100 million, 10-year index-linked loan with an existing relationship bank.

In April 2015, UUW's financing subsidiary, United Utilities Water Finance PLC (UUWF), issued two index-linked notes totalling £60 million, consisting of a £25 million, 10-year maturity and a £35 million, 15-year maturity. UUWF also issued a €52 million note (swapped to floating sterling) with a 12-year maturity. All these notes were issued via private placement off our EMTN programme.

In the second half of 2015/16, UUW arranged two £100 million loans with existing relationship banks; a seven-year floating rate loan, drawn down in December 2015 and a 10-year index-linked loan, drawn down in March 2016. UUWF issued a €30 million private placement note (swapped to floating sterling), with a 15-year maturity, off our EMTN programme in October 2015. In addition, the group agreed £50 million of new five-year committed bank facilities.

In April 2016, UUW signed a £250 million index-linked term loan facility with the EIB to support the delivery of UUW's AMP6 investment programme. This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and is the first tranche of an anticipated £500 million funding package for AMP6 from the EIB, with the second tranche expected to be made available for signature later in the AMP. In May 2016, United Utilities PLC signed a new seven-year revolving credit facility with an existing relationship bank. Following the signing of these facilities, the group now has headroom to cover its projected financing needs through until mid-2018.

Term debt maturity per regulatory period*



* Future repayments of index-linked debt include inflation based on an average annual RPI rate of 3%.

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

Long-term sterling inflation index-linked debt provides a natural hedge to assets and earnings. At 31 March 2016, approximately 55 per cent of the group's net debt was in index-linked form, representing around 34 per cent of UUW's regulatory capital value, with an average real interest rate of 1.5 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 around 20 years.

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

In line with this, the group has fixed interest costs for substantially all of its floating rate exposure over the 2015-20 period, locking in an average annual interest rate of around 3.7 per cent (inclusive of credit spreads). For 2015/16, the rate was slightly higher, as we transitioned between the two regulatory periods.

Liquidity

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

Available headroom at 31 March 2016 was £269 million based on cash, short-term deposits, committed bank facilities, along with the undrawn portion of the EIB term loan facilities (signed at that time), net of short-term debt as well as committed facilities and term debt falling due within 12 months.

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 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 2016, the group had an IAS 19 net pension surplus of £275 million, compared with a net pension surplus of £79 million at 31 March 2015. This £196 million favourable movement mainly reflects the impact of a significant increase in credit spreads, reducing the IAS19 pension liability, partially offset by an increase in inflation assumptions. In contrast, the scheme specific funding basis does not suffer from volatility due to inflation and credit spread movements as it uses a fixed inflation assumption via the inflation funding mechanism and a prudent, fixed credit spread assumption. Therefore, the recent inflation and credit spread movements have not had a material impact on the deficit calculated on a scheme specific funding basis or the level of deficit repair contributions.

Further detail on pensions is provided in note 18 ('Retirement benefit surplus') of these consolidated financial statements.

Our performance 2015/16

Underlying profit

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

Operating profit	**Year ended 31 March 2016 £m**	Year ended 31 March 2015 £m
Operating profit per published results	**567.9**	653.3
Water quality incident	**24.8**	–
Flooding incidents (net of insurance proceeds recognised)	**(0.6)**	–
Business retail market reform[1]	**11.1**	–
Restructuring costs	**0.9**	11.0
Underlying operating profit	**604.1**	664.3

Net finance expense	**£m**	£m
Finance expense	**(224.4)**	(317.8)
Investment income	**5.0**	1.0
Net finance expense per published results	**(219.4)**	(316.8)
Adjustments:		
Net fair value losses on debt and derivative instruments	**26.3**	104.7
Interest on swaps and debt under fair value option	**16.5**	4.0
Net pension interest (income)/expense	**(3.1)**	7.0
Capitalised borrowing costs	**(21.3)**	(20.9)
Underlying net finance expense	**(201.0)**	(222.0)

Profit before tax	**£m**	£m
Share of profits of joint ventures	**5.0**	5.1
Profit before tax per published results	**353.5**	341.6
Adjustments:		
Water quality incident	**24.8**	–
Flooding incidents (net of insurance proceeds recognised)	**(0.6)**	–
Business retail market reform[1]	**11.1**	–
Restructuring costs	**0.9**	11.0
Net fair value losses on debt and derivative instruments	**26.3**	104.7
Interest on swaps and debt under fair value option	**16.5**	4.0
Net pension interest (income)/expense	**(3.1)**	7.0
Capitalised borrowing costs	**(21.3)**	(20.9)
Underlying profit before tax	**408.1**	447.4

Profit after tax	**£m**	£m
Underlying profit before tax	**408.1**	447.4
Reported tax credit/(charge)	**44.0**	(70.4)
Deferred tax credit – change in tax rate	**(112.5)**	–
Agreement of prior years' UK tax matters	**(3.4)**	(0.7)
Tax in respect of adjustments to underlying profit before tax	**(10.9)**	(22.2)
Underlying profit after tax	**325.3**	354.1

Earnings per share	**£m**	£m
Profit after tax per published results (a)	**397.5**	271.2
Underlying profit after tax (b)	**325.3**	354.1
Weighted average number of shares in issue, in millions (c)	**681.9m**	681.9m
Earnings per share per published results, in pence (a/c)	**58.3p**	39.8p
Underlying earnings per share, in pence (b/c)	**47.7p**	51.9p

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

Underlying operating profit reconciliation

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

Continuing operations Underlying operating profit	Year ended 31 March 2016 £m
Group underlying operating profit	**604.1**
Underlying operating loss not relating to UUW	**7.2**
UUW statutory underlying operating profit	**611.3**
Revenue recognition	**(0.2)**
Capitalised borrowing costs	**2.8**
Other differences (including non-appointed business)	**(8.3)**
UUW regulatory underlying operating profit	**605.6**

Principal risks and uncertainties

We identify and manage risks using our risk management framework

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

All parts of the group use the same risk management framework ensuring consistency of approach and supporting risk management and monitoring. The framework includes: an embedded governance and reporting process (see figure 1); an assessment and management process which is aligned to ISO 31000: 2009 (see figure 2); and a central database, tools and guidance to further support consistency, embedment and continuous improvement.

Leaders within the group's individual business areas and functions are responsible for the assessment and management of risk including the identification and escalation of new/emerging circumstances and the monitoring and reporting on risk and control effectiveness. All event types (strategic, financial, operational, compliance and hazard) are considered in the context of their potential impact on the delivery of our business objectives. The assessment is based on the likelihood of an event occurring and the financial and reputational impact should the event occur. The assessment takes into account a gross position (without controls or assuming that all controls fail), a current position benefitting from existing controls and a targeted position where further mitigation is required to meet objectives or obligations.

The resulting risk profile is reported to the group board twice a year. The report covers four areas: the 10 highest ranked risks (based on likelihood x impact); a further five risks included due to the potential severity of their impact; risks that fall outside these categories but are included due to potential reputational impact or new/emerging circumstances; and a summary of all of the event-based risks within the profile relative to 10 principal risks (see pages 48 and 49) that could seriously affect the performance, future prospects or reputation of the business.

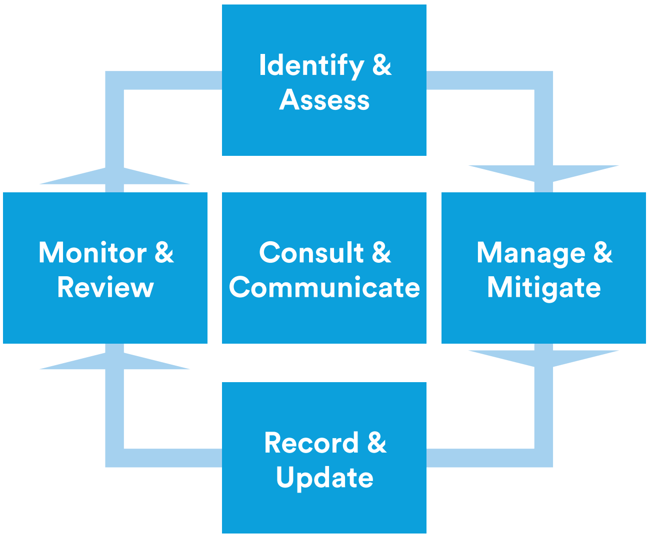
This approach is in line with the principles of the UK Corporate Governance Code and involves reporting to the group board for each full and half year statutory accounting period allowing the board to:

- determine the nature and extent of the principal risks it is willing to take in achieving its strategic objectives;
- oversee the management of those risks and provide challenge to executive management where appropriate;
- express an informed opinion on the long-term viability of the company (see page 71); and
- monitor risk management and internal control systems and review their effectiveness.

Figure 1: United Utilities' governance and reporting structure for risk management and internal control

Read our **Long-term viability statement** on page **71**

Figure 2: United Utilities' risk management process (adapted from ISO 31000: 2009)



Our risk profile currently consists of around 200 event-based risks. By their nature, these will include all combinations of high to low likelihood and high to low impact. Heat maps (see figure 3) are typically used in various managerial and group reports either as a method to collectively evaluate the extent of multiple risks within a certain profile or to evaluate the effectiveness of mitigation for a single risk relative to the initial gross position.

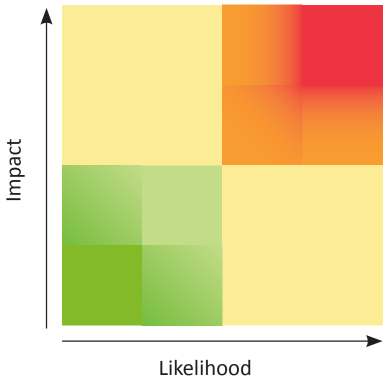


Figure 3: Indicative heat maps are used to evaluate and report risk

Key features and developments

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

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

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

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

Principal risks

The principal risks (aggregated clusters of event-based risks), which have been set out in the table on pages 48 and 49 reflect the categories of risks that define business activity or contributing factors where value can be lost or gained and could have a material impact on the business model, future performance, solvency or liquidity of the group. In each case the magnitude of the potential effect is highlighted together with the extent of management/mitigation. To ensure relevance with the current environment, issues or areas of uncertainty are also illustrated.

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

- In February 2009, United Utilities International Limited (UUIL) was served with notice of a multiparty 'class action' in Argentina related to the issuance and payment default of a US$230 million bond by Inversora Eléctrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The claim is for a non-quantified amount of unspecified damages and purports to be pursued on behalf of unidentified consumer bondholders in IEBA. UUIL has filed a defence to the action and will vigorously resist the proceedings given the robust defences that UUIL has been advised that it has on procedural and substantive grounds.
- In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water Limited (UUW) in respect of UUW's discharges of water and treated effluent into the canal. Whilst the matter has not reached a final conclusion, the Supreme Court has found substantively in UUW's favour on a significant element of the claim and the High Court has upheld UU's position on the remainder of the proceedings. We await to see whether MSCC pursue a further claim to introduce additional matters for determination.

Principal risks and uncertainties

Risk description	Main business objective	Potential impact
Regulatory environment and framework The potential change in the regulatory environment and/or frameworks	Lowest sustainable cost	Changes to regulation and the regulatory regime (either through political or regulatory events) may increase costs of administration, reduce income and margin and lead to greater variability of returns.
Corporate governance and legal compliance The failure to meet all legal and regulatory obligations and responsibilities	Responsible manner	Non-compliance with existing or future laws/regulations (principally relating to the regulated business, but also including non-regulated activity/commitment) can result in additional workload, financial penalties, additional capital/operating expenditure (from enforcement orders or legal defence) and compensation following litigation. In more remote but extreme circumstances, penalties of up to 10 per cent of relevant turnover and ultimately revocation of our licence or the appointment of a special administrator are possible.
Water service The inability to provide a secure and resilient supply of clean, safe drinking water	Best service to customers	Operational performance problems or service or asset failures can lead to additional operating or capital expenditure and/or increased regulatory scrutiny and regulatory penalties. In more extreme situations the group could also be fined for breaches of statutory obligations, be subject to enforcement action, be held liable to third parties and sustain reputational damage.
Wastewater service The inability to remove, treat and return wastewater to the environment in an effective, resilient and compliant manner	Best service to customers	
Security The inability to protect people, information and assets from malicious or accidental activity	Best service to customers	Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) which could impact the provision of vital services and/or harm people or commercial businesses.
Human, technological and physical resource The inability to support/deliver effective and efficient business activity	Responsible manner	The capacity or capability associated with human, technological and physical resource (including information, operational technology, skill sets, systems and telephony) can impact the efficiency and effectiveness of business activity, the ability to make appropriate decisions and ultimately meet targets. This can also affect the ability to recruit and retain knowledge/expertise or to recover effectively following an incident. In remote but extreme circumstances there is also the potential for higher levels of regulatory scrutiny, financial penalties, reputational damage and missed commercial opportunities.
Financial risk The inability to appropriately finance the business due to capital, credit, market, funding, liquidity or tax-related risk	Lowest sustainable cost	The failure of financial counterparties could result in additional financing cost, an adverse impact on the income statement and potential reputational damage. Variability in inflation (as measured by the UK Retail Prices Index) and changes in interest rates, funding costs and other market risks could adversely impact the economic return on the regulatory capital value (RCV) and affect our pension schemes with a requirement for the group to make additional contributions. In extreme but remote cases adverse market conditions could affect our access to debt capital markets and subsequently available liquidity and credit ratings.
Programme delivery The ineffective or inefficient delivery of capital, operational and change programmes	Lowest sustainable cost	Failure to deliver capital or change programmes against relevant time, cost or quality measures could result in a failure to secure competitive advantage or operating performance efficiency and cost benefits. There is also the risk of increased delivery costs or a failure to meet our obligations and customer outcomes which, depending on the nature and extent of failure, could result in an impact at future price reviews, regulatory or statutory penalties and negative reputational impact with customers and regulators.
Revenues The inability to maintain revenues and margin due to customer service provision	Lowest sustainable cost	Poor service to customers can result in financial penalties issued by the regulator through components of the service incentive mechanism for household customers and loss of revenue associated with commercial churn for non-household customers using five megalitres and above per annum. The proposed opening of the market for retail services to all non-household customers in England from 2017 generates both opportunities and risk associated with market share, scale and margin erosion. There is also much uncertainty surrounding the form of upstream reform which is now anticipated to materialise after 2019.
Health, safety and environmental The potential harm to employees, contractors, the public or the environment	Responsible manner	Working with and around water, sewage, construction and excavation sites, plant and equipment exposes people and the environment to various man-made and naturally occurring hazards. The nature and extent of exposure could result in harm to people, wildlife and natural habitats. Depending on the circumstances, the group could be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage.

Risk exposure

An indication of each category's current exposure relative to the previous year is shown by the arrow in the risk exposure column.

↓ reducing ↔ stable ↑ increasing

Current key risks, issues or areas of uncertainty include:	Risk exposure	Management and mitigation
– Market reform including non-household and upstream competition and, further ahead, the potential for the introduction of household competition – A possible change from using the retail prices index to the consumer prices index for regulatory indexation	↑	We engage in relevant government and regulatory consultations which may affect policy and regulation in the sectors where we operate. We also consult with customers to understand their requirements and proactively consider all the opportunities and threats associated with any potential change, exploiting opportunities and mitigating risks where appropriate.
– Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market – Current material litigation – New higher fine levels for environmental offences	↑	Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any material additional compliance costs in the regulated business is sought as part of the price determination process. The group also robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible.
– Population growth – Climate change – Meeting infrastructure investment requirements – Expected change to the abstraction licensing regime – Catchment management – Raw water quality – Drinking water safety and security	↔ ↔	Mitigation is provided through core business processes, including forecasting, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Ongoing system and network integration improves service provision and measures of success have been developed to monitor performance. Following the Lancashire water quality incident in 2015 we are further enhancing our approach to operational risk and resilience.
– Cybercrime – Terrorism – Other criminality relating to assets or operations	↔	Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Recent initiatives include awareness training across the business relating to seven key areas of security and the implementation of a security governance model to oversee all aspects of security and security strategy. Ongoing system and network integration improves operational resilience and we maintain robust incident response, business continuity and disaster recovery procedures. We also maintain insurance cover for loss and liability and the licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers in the event of a catastrophic incident.
– Delivering required employee engagement – Personal development and talent management – Technological innovation – Asset management	↔	Developing our people with the right skills and knowledge, combined with delivering effective technology are important enablers to support the business to meet its objectives. Employees are kept informed regarding business strategy and progress through various communication channels. Training and personal development programmes exist for all employees in addition to talent management programmes and apprentice and graduate schemes. We focus on change programmes and innovative ways of working to deliver better, faster and more cost-effective operations.
– Stability of financial institutions and the world economy – Economic uncertainty – Inflation/deflation – Financial market conditions, interest rates and funding costs – Brexit	↑	Refinancing is long-term with staggered maturity dates to minimise the effect of short-term downturns. Counterparty credit, exposure and settlement limits exist to reduce any potential future impacts. These are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. The group also employs hedging strategies to stabilise market fluctuation for inflation, interest rates and commodities (notably energy prices). Sensitivity analysis is carried out as part of the business planning process, influencing the various financial limits employed. Continuous monitoring of the markets takes place including movements in credit default swap prices and movements in equity levels.
– Security of supply – Delivery of solutions – Quality and innovation – New contract delivery partnerships for the 2015–2020 period with a new approach to construction and design – Price volatility	↔	We have a developed and clear view of our investment priorities which are built into our programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service provider including alignment with our operating model. Our programme and project management capabilities are well established with strong governance and embedded processes to support delivery, manage risks and achieve business benefits. We utilise a time, cost and quality index (TCQi) as a key performance indicator and enhance our performance through a dedicated programme change office to deliver change in a structured and consistent way. Supply chain management is utilised to deliver end-to-end contract management which includes contract strategy and tendering, category management, security of supply, price and price volatility and financial and operational service level performance.
– Socio-economic deprivation in the North West – Welfare reform and the impact on domestic bad debt – Competition in the water and wastewater market and competitor positioning – Brexit – Market Reform and the ability to treat other participants equally	↑	For Domestic Retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Similarly, within Business Retail we look to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitor competitor activity and target a reduction in operating costs. Within our wholesale department processes, systems, data and organisational capacity and capability to deal with market participants and the central market operator are being prepared. The new market requirements will require all market participants to treat other participants equally ('on a level playing field') whilst maintaining compliance with existing regulations.
– Excavation, tunnelling and construction work – Working with water and wastewater – Chemicals – All weather conditions – Driving, vehicle movement	↔	We have developed a strong health, safety and environmental culture where 'nothing we do at United Utilities is worth getting hurt for'. This is supported by strong governance and management systems which include policies and procedures which are certified to OHSAS 18001 and ISO 14001.

Ensuring the long-term success of the company and the group

The corporate governance report presents information on the board of United Utilities and its activities and those of the various committees, and sets out how the board demonstrates leadership, effectiveness and its accountability to the company's stakeholders and its approach to the remuneration of the directors.

Pictured: Thirlmere reservoir, Cumbria.

Governance

Corporate governance report
Board of directors

Dr John McAdam (68)
Chairman

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

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

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

Committee membership: Nomination (chair).

Skills and experience: With over 17 years' service as a board director in a wide range of companies, and as a current non-executive director serving on a number of other boards, John has a wealth of experience on which to draw in his role as Chairman and leader of the board.

Career experience: Appointed to the board of ICI plc in 1999 and became chief executive in 2003, a position held until ICI's takeover by Akzo Nobel.

Current directorships/business interests: Chairman of Rentokil Initial plc, senior independent director of J Sainsbury plc (stepping down at the AGM to be held on 6 July 2016) and a non-executive director of Rolls-Royce Holdings plc. He is also Chairman of United Utilities Water Limited.

Independence: John met the Code's independence criteria at the time of his initial appointment as Chairman.

Steve Mogford (59)
Chief Executive Officer (CEO)

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

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

Appointment to the board: January 2011.

Committee membership: Corporate responsibility.

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

Career experience: Previously chief executive of SELEX Galileo, the defence electronics company owned by Italian aerospace and defence organisation Finmeccanica, and chief operating officer at BAE Systems PLC and a member of its PLC board, he spent his earlier career with British Aerospace PLC. He stepped down as senior independent director at Carillion PLC in September 2015 and from the board in December 2015.

Current directorships/business interests: Appointed as senior independent director of G4S PLC in May 2016. He is also chief executive officer of United Utilities Water Limited.

Russ Houlden (57)
Chief Financial Officer (CFO)

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.

Skills and experience: Russ's skills and experience in accounting, treasury, tax, M&A and investor relations in other commercial and regulated companies, along with his extensive experience of driving performance improvement and managing large capital investment programmes, provides the group with valuable expertise with regard to its drive for improvements in customer service, business development, operations, capital investment and financing.

Career experience: Chief financial officer at Telecom New Zealand. Previously finance director of Lovells, BT Wholesale, BT Networks and Information Services, ICI Polyurethanes and ICI Japan.

Current directorships/business interests: Member of the supervisory board and chairman of the audit committee of Orange Polska SA, the largest listed telecommunications company in Poland. He is a member of the main committee and chairman of the financial reporting committee of the 100 Group. He is also chief financial officer of United Utilities Water Limited.

Dr Catherine Bell (65)
Independent non-executive director

Responsibilities: To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the board's agenda on acting responsibly as a business.

Qualifications: MA Geography, PhD Economic History.

Appointment to the board: March 2007.

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

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

Career experience: Formerly a non-executive director of the Civil Aviation Authority and prior to that a former civil servant and acting permanent secretary at the Department for Trade and Industry. Previously a non-executive director of Ensus Limited and Swiss Re GB Plc.

Current directorships/business interests: Non-executive director and executive board member of the Department of Health and a non-executive director of National Grid Gas plc and National Grid Electricity Transmission plc. She is also an independent non-executive director of United Utilities Water Limited.

Catherine is not seeking reappointment at the 2016 AGM.

Stephen Carter (52)
Independent
non-executive director

Responsibilities: To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board.

Qualifications: Bachelor of Law.

Appointment to the board: September 2014.

Committee membership: Nomination, audit and corporate responsibility.

Skills and experience: As the CEO of a FTSE listed company, Stephen brings current operational experience to the board. His time spent in public service provides additional insights to the board regarding regulation and government relations, and his experience in the media and technology industries provides a new perspective for the board's discussions.

Career experience: Prior to his appointment as group chief executive at Informa plc on 1 January 2014, he was appointed CEO designate on 1 September 2013, having previously served on its board as an independent non-executive director and member of the audit committee. He has also held non-executive director positions at Travis Perkins plc and Royal Mail Holdings plc. Previous roles include president/managing director, Europe, Middle East & Africa, and a member of the executive management board at Alcatel Lucent Inc. Stephen has also held a number of public service roles, serving a term as the founding chief executive of Ofcom. He was formerly chairman of the board at Ashridge Business School. He is a Life Peer.

Current directorships/business interests: Group chief executive at Informa plc and a governor of the Royal Shakespeare Company. He is also an independent non-executive director of United Utilities Water Limited.

Mark Clare (58)
Senior independent
non-executive director

Responsibilities: Is responsible, in addition to his role as an independent non-executive director, for discussing any concerns with shareholders that cannot be resolved through the normal channels of communication with the Chairman or Chief Executive Officer.

Qualifications: Chartered Management Accountant (FCMA).

Appointment to the board: November 2013.

Committee membership: Nomination, remuneration.

Skills and experience: As a former CEO of a FTSE100 company Mark brings recent current operational experience to the board. His time at British Gas and BAA means he has a strong background operating in a regulated environment and his extensive knowledge of customer-facing businesses is particularly valuable as the industry prepares for increased competition and pursues its continuous drive to improve customer service.

Career experience: Mark retired from his position as group chief executive at Barratt Developments plc in July 2015, a role he had held for nine years. He is a former trustee of the Building Research Establishment and the UK Green Building Council. Prior to joining Barratt, he was an executive director of Centrica plc and held a number of senior roles within both Centrica plc and British Gas. Mark has also been a non-executive director of BAA plc, the airports operator.

Current directorships/business interests: He is also an independent non-executive director of United Utilities Water Limited.

Brian May (52)
Independent
non-executive director

Responsibilities: To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the audit committee.

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

Appointment to the board: September 2012.

Committee membership: Nomination, audit (chair), treasury (chair).

Skills and experience: Brian joined Bunzl plc in 1993 as head of internal audit before becoming group treasurer, then finance director (Europe and Australasia), and is currently finance director. Brian's background and the various finance roles that he has held are major assets to the board in chairing both the audit and the treasury committees.

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

Current directorships/business interests: Finance director at Bunzl plc. He is also an independent non-executive director of United Utilities Water Limited.

Sara Weller (54)
Independent
non-executive director

Responsibilities: To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the board's activities concerning directors' remuneration.

Qualifications: MA Chemistry.

Appointment to the board: March 2012.

Committee membership: Nomination and remuneration (chair).

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

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

Current directorships/business interests: Non-executive director of Lloyds Banking Group plc and former lead non-executive director for the Department for Communities and Local Government. Sara is chair of the Planning Inspectorate (an executive agency of the Department of Communities and Local Government), a board member at the Higher Education Funding Council for England and a council member at Cambridge University. She is also an independent non-executive director of United Utilities Water Limited.

Corporate governance report
Letter from the Chairman

Dr John McAdam, Chairman

Quick facts

The Chairman met the independence criteria as set out in the 2014 UK Corporate Code (the Code) when he was appointed as Chairman

The Code requires that at least half of the board is made up of independent non-executive directors (the test excludes the Chairman). At United Utilities, five out of the remaining seven directors (excluding the Chairman) are independent non-executive directors

The company secretary attends all board and committee meetings and advises the Chairman on governance matters. The company secretariat team provides administrative support

All directors are subject to annual election at the AGM held in July. Following the completion of the annual evaluation process all the non-executive directors were considered by the board to be independent and making a valuable and effective contribution to the board. As a result, the board recommends that shareholders vote in favour of those standing for a further term at the forthcoming AGM

Quick links

The details of the matters that the board has reserved for its own decision are set out in the 'Schedule of matters reserved for the board'. A copy can be found at **corporate.unitedutilities.com/corporate-governance**

A copy of the FRC 2014 UK Corporate Governance Code can be found at **frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf**

The board asked Mark Clare, our senior independent director, to undertake our own investigation in order that lessons could be learnt and appropriate actions taken.

Dear Shareholder

Our year

2015/16 has been a challenging year for the group. Key areas of focus for the board have included ensuring that the programme of building water and wastewater assets for the new AMP is well under way, with around £800 million of the total £3.5 billion having been spent in the first year. Secondly, we announced on 1 March 2016 that we would enter into a joint venture with Severn Trent, combining the two companies' non-household water and wastewater retail businesses subject to obtaining clearance from the Competition and Markets Authority (CMA). Clearance was announced by the CMA on 3 May 2016. The board's view was that the synergies created through combining the two businesses would provide an efficient and cost-effective operation focused on improved customer service, increased efficiency and enhanced value for shareholders. Thirdly, we have had some major operational challenges during the year that have impacted a large number of our customers in Lancashire and Cumbria, which will have tested to the full their faith in our commitment to customer service. The board was kept fully informed of the progress of these incidents and held a number of board teleconference calls to discuss the approach being taken by management to restore normal service to customers. The board was extremely disappointed that these incidents occurred and for the inconvenience caused to our customers. In addition to the investigation of the Lancashire water quality incident by the Drinking Water Inspectorate, the board asked Mark Clare, our senior independent director, to undertake our own investigation in order that lessons could be learnt and appropriate actions taken.

Our approach

As individual directors we are cognisant of our statutory duties. Our role as the board is to set the strategy of the group and ensure that management operates the business in accordance with the strategy in order to safeguard both its long-term success and customers' interests, and to create shareholder value. As a board we have a strong sense of common purpose: our intention is to hand over the business to our successors in a better and more sustainable position for the future. Information on our vision and strategy and the way in which we create value is included in the strategic report on pages 4 to 49.

Our governance structure

We held eight scheduled board meetings during the year; in addition, there were also a number of board meetings held which directors attended either in person or via telephone conferencing facilities, a number of which related to the board's involvement in the Lancashire water quality incident. A diagram showing the inter-relationships of the various board committees can be found on page 58, and reports from each of the committee chairs about their work can be found on the following pages. The diagram also describes some of the group's principal management committees.

Our people

Catherine Bell will be stepping down from the board at the AGM on 22 July 2016. Catherine has chaired the corporate responsibility committee and been a key component in driving forward the board's corporate responsibility agenda. As a result, during the year, the nomination committee undertook the process of recruiting a new independent non-executive director. We announced on 5 May 2016 that Alison Goligher will join the board as a non-executive director with effect from 1 August 2016 (see page 66).

We have maintained our target of at least 25 per cent of our board comprising women. In terms of diversity of experience, skills and personal attributes, I believe we have great diversity around our board; the directors have many years of experience gained across a variety of industries, with regulatory backgrounds. Good board dynamics are vital to the proper interaction and working of a board of directors. Board directors need to work together effectively for the good of the company and, in short, they need to get on with each other; clashes of personality are to be avoided as they do not facilitate constructive debate and challenge or effective communication. I believe we have individuals who will apply their skills and experience to the benefit of our business and speak up if they disagree but, equally, listen to the views of others.

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

At the time this report was approved, 40 per cent of our executive team is made up of women. We are keen to develop our female senior managers so that, over time, they can be considered for executive board appointments or as potential candidates for non-executive directorships in other companies. We believe a non-executive appointment provides an excellent opportunity for both personal and career development and it is a way of gaining valuable experience that may be applied at United Utilities so long as no conflicts of interest occur.

Our culture and values

Our aim is to act as a responsible business, and our business principles can be found on our website (see page 63). Our core values of acting with integrity and focusing on our customers provides the framework of our business culture and for our employees in the way in which they go about their daily work. The board's role is to set the strategic objectives and ensure that management takes responsibility for implementation. Should our employees have concerns about wrongdoing or potential breaches of our business principles then they can raise their concerns anonymously via a confidential whistleblowing telephone service. Any concerns reported would then be investigated.

Notwithstanding the challenges of the water quality incident in Lancashire, what shone through for the board was the behaviour of our employees. The 'tone from the top' was demonstrated by Steve Mogford's personal leadership of the incident, and our staff worked tirelessly to restore water quality as quickly as possible. On behalf of the board, I wish to extend our gratitude to them; this provides but one example of the dedicated approach our employees have to serving our customers and their importance as an asset of our business.

In accordance with our aim of acting as a responsible business, the company has complied fully with the 2014 UK Corporate Governance Code with which we are required to comply by the FCA's Listing Rules for the year ended 31 March 2016.

Our approach to risk

Our attitude toward risk is very much aligned with our culture. We are an organisation that provides a vital service to its customers and we recognise the responsibilities of this, and our intention is to act responsibly towards our stakeholders, in particular our customers, in the provision of our services to them. As a board, on behalf of our business we must take long-term decisions in order that our successors are able to operate the business efficiently for customers in the future and we need to build our assets to meet future demand and circumstances. All things being equal, we are a commercial organisation operating within a regulated framework, and accepting some level of risk is a normal consequence of doing business. It is the board and the executive team's role to understand the risks associated with each activity of the business and ensure that actions are taken to mitigate these risks.

Our investors

We are in regular contact with our large investors through a regular scheduled programme of meetings attended by either our CEO or CFO or both of them; the programme is also supported by the activities of our investor relations team. Ensuring that executive directors' remuneration packages align the directors' and senior managers' interests with the long-term interests of the company and its shareholders is always a key area of interest for investors. The executive remuneration policy was approved by shareholders at the 2014 AGM, and is intended to apply until the 2017 AGM. At the time of the introduction of the new policy, the remuneration committee under Sara Weller's leadership went to considerable effort to consult on the changes with a number of the company's large investors and their feedback was taken into account. Although only advisory, at both the AGMs in 2014 and 2015 over 99 per cent of the votes were cast in favour of the directors' remuneration report. We welcome any feedback you may have on this annual report – please email any comments you may have to **secretariat@uuplc.co.uk**

Finally, I would like to wish Catherine every success for the future and thank her for her extensive contribution to the board and United Utilities.

Dr John McAdam
Chairman

Corporate governance report

Code principles

Leadership

Read more on pages 56 to 60

Effectiveness

Read more on pages 60 to 68

Relations with shareholders

Read more on pages 69 to 70

Accountability

Read more on pages 70 to 79

Remuneration

Read more on pages 82 to 101

Code principle – Leadership

Introduction by Dr John McAdam

"As the board of directors we are collectively responsible for the long-term success of the company, although there is a clear division of responsibility between the non-executive directors whose role is to challenge and advise and the executive directors who have responsibility for running and operating the business. The executive directors provide the board with its window into the business and the relationships within the board need to be built on trust. Board colleagues are always extremely supportive of the need to supplement the scheduled board calendar with conference calls and are generous with their advice and input."

Overview of the board's responsibilities

- The board sets the strategy of the group, ensuring the long-term success of the group for customers, investors and wider stakeholders, and in creating shareholder value
- The board is responsible for challenging and encouraging the executive team in its interpretation and implementation of how it manages the business, and that it is doing so in accordance with the strategic goals the board has set
- The board has responsibility for ensuring the company's internal control systems (including financial, operational and compliance) and processes are sound and fit for purpose. See the 'accountability' section of this report on page 70 for more detail
- The board must ensure that the company has the necessary financial resources and people with the necessary skills to achieve its objectives. It also reviews managerial performance annually
- The UUG board has oversight of capital expenditure projects within UUW which exceed £50 million, and any project which materially increases the group's risk profile or is not in the ordinary course of the group's business
- Full details of the matters that the board has reserved for its own decision-making, due to their importance to the business or the working of the board, can be found on our website at **corporate.unitedutilities.com/corporate-governance**

Pictured right: Rooden reservoir, Piethorne Valley, Greater Manchester.

Governance structure for our board and our committees

In line with the Code, the board delegates certain roles and responsibilities to its principal board committees, as shown in the diagram on page 58. Whilst the board retains overall responsibility, a sub-committee structure allows these committees to probe the subject matter more deeply and gain a greater understanding of the detail, and then report back to the board on the matters discussed, decisions taken, and where appropriate make recommendations to the board on matters requiring its approval. The reports of the principal board committees required by the Code can be found on the subsequent pages. Minutes of the board and principal committee meetings (with the exception of the remuneration committee) are tabled at board meetings and the chairs of each of the board committees report verbally to the board on their activities. The Chairman chairs the nomination committee; all other principal board committees are chaired by independent non-executive directors who have particular skills or interests in the activities of those committees.

The executive team is chaired by the CEO, and its members are the senior managers who have a direct reporting line to the CEO. The executive team meets monthly; it is responsible for operational matters and implementing the strategies that the board has set, and the day-to-day running of the business. Short biographies of the executive team can be found on our website at **corporate.unitedutilities.com/united-utilities-executive-team**

The structure chart shown on page 58 also shows the principal management committees and a brief description of their roles. These committees enable senior management to understand and, if necessary, challenge the business in its interpretation of the implementation of the strategies the board has set. The board received reports from the CEO and CFO at every scheduled board meeting, providing the board with an updated overview of the business and its financial position.

Corporate governance report

Governance structure of the board and its principal committees and the principal management committees.

Group Board
Chair: Dr John McAdam

Chief Executive Officer
Steve Mogford

Principal board committees

Audit committee
Chair: Brian May

Read more on pages **72** to **79**

Remuneration committee
Chair: Sara Weller

Read more on pages **82** to **101**

Nomination committee
Chair: Dr John McAdam

Read more on pages **64** to **68**

Corporate responsibility committee
Chair: Dr Catherine Bell

Read more on pages **80** to **81**

Treasury committee
Chair: Brian May

The committee considers and approves borrowing, leasing, bonding and other banking facilities within limits set by the board. The CFO and treasurer are also members. Some powers are sub-delegated, within certain limits, to the CFO and treasurer.

Principal management committees

Executive team
Chair: Steve Mogford, CEO

This forum is responsible for implementing the board's strategy and the day-to-day operation of running the business and the CEO will cascade decisions made by the board to the business via this forum.

Group audit and risk board
Chair: Steve Mogford, CEO

Read more on page **79**

Security governance board
Chair: Sally Cabrini, business services director

This forum is responsible for setting and ensuring the implementation of the security goals of the business, encompassing all elements of security, i.e. IT and systems security, physical security, fraud, business continuity and resilience and any emerging security issues.

Quarterly business review
Chair: Steve Mogford, CEO

This forum is responsible for the quarterly review of operational and financial performance.

Political and regulatory steering group
Chair: Gaynor Kenyon, corporate affairs director

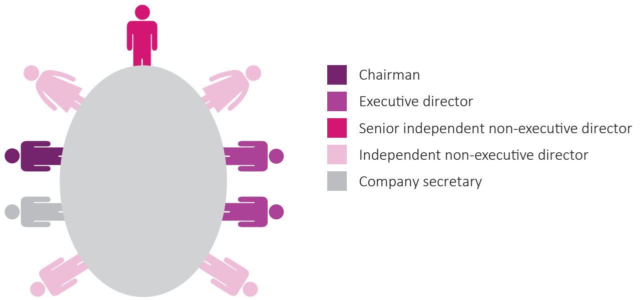
This forum is responsible for discussing political and regulatory issues affecting the company, where any 'horizon scanning' issues are raised and business responses to consultations are agreed.

Key:
Best service to customers | Lowest sustainable cost | Responsible manner

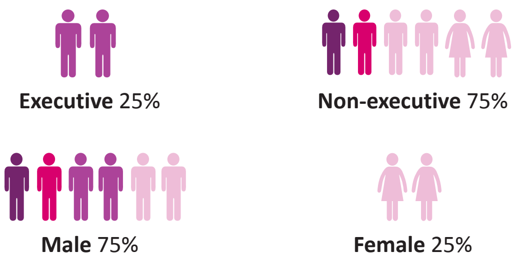
Board activity in 2015/16	Cross reference	Link to strategic objectives
Leadership and employees		
– Reviewed and discussed the health and safety of employees	See page 38	
– Considered board succession planning and the appointment of a new non-executive director	See page 65	
– Reviewed and discussed executive succession plans and the needs of the business and received an update on the activities to develop talented employees and the people plan	See page 67	
– Discussed the results of the annual employee engagement survey	See page 37	
Strategy		
– Debated and discussed non-household water and wastewater retail businesses and the joint venture with Severn Trent	See page 8	
– Approved the group's updated corporate responsibility framework and business principles	See page 63	
– Held a strategy session debating and discussing the future direction of the Wholesale business and the opportunities for growth outside the regulated boundaries of the business		
Governance		
– Reviewed and debated the risk profile of the group and in particular the principal risks	See page 48	
– Approved designated authority levels for the group's non-regulated activities		
– Reviewed and discussed updates on cyber security and information management strategies	See page 48	
– Reviewed the terms of reference for the audit, remuneration, treasury and corporate responsibility committees and received post-meeting reports from the chairs of each committee summarising discussions and actions		
– Reviewed biannual updates on changes and developments in corporate governance and the implementation of any changes required		
– Reviewed and discussed the evaluation of the board, its committees and individual directors and conflicts of interest	See page 60	
– Reviewed the performance of the external auditor and recommendation for reappointment	See page 75	
– Reviewed the effectiveness of the risk management and internal control systems	See page 70	
Regulation (UUW business)		
– Reviewed the group's response and management of the Lancashire water quality incident and independent reviewers' reports and lessons learnt	See page 32	
– Monitored progress of the implementation of the customer experience programme	See page 25	
Non-regulated business		
– Reviewed progress on the group's renewable energy generation and opportunities for expansion	See page 37	
Shareholder relations		
– Received and discussed a presentation by Makinson Cowell on investors' views and perceptions	See page 69	
– Received and discussed feedback from roadshows/presentations to investors by the CEO and/or the CFO	See page 69	
Financial		
– Reviewed and approved the 2015-20 dividend policy	See page 6	
– Reviewed and approved the half and full-year results and associated announcements		
– Reviewed and approved the company's tax strategy	See page 39	
– Reviewed and approved the company's treasury policy and insurance arrangements		
– Reviewed progress with material cases of litigation involving the group	See page 47	
– Reviewed and discussed pensions and proposals in relation to the UU defined benefit pension scheme	See page 43	

Corporate governance report

The boardroom table



Board composition



Attendance at board and committee meetings

Eight scheduled board meetings were planned and held during the year (2015: eight). A number of other board meetings and telephone conferences were also held during the year, as the need arose. The table below shows the actual number of scheduled meetings attended and the maximum number of scheduled meetings which the directors could have attended. Only in exceptional circumstances would directors not attend board and committee meetings. Similarly, every effort is made to attend ad hoc meetings either in person or via the use of video or telephone conferencing facilities if needs be. None of our non-executive directors have raised concerns over the time commitment required of them to fulfil their duties.

On the evening before most scheduled board meetings all the non-executive directors meet together with the CEO; this time is usefully spent enabling board colleagues to share views and consider issues impacting the company. Time together also helps to build relationships on a personal level, which contributes to better relationships and decision-making around the board table.

	Board meetings	Audit committee	Remuneration committee	Nomination committee	Corporate responsibility committee	Treasury committee
Dr John McAdam	8/8	–	–	3/3	–	–
Steve Mogford	8/8	–	–	–	2/2	–
Russ Houlden	8/8	–	–	–	–	4/4
Dr Catherine Bell	8/8	4/4	4/4	3/3	2/2	–
Stephen Carter	8/8	4/4	–	3/3	2/2	–
Mark Clare	8/8	–	4/4	3/3	–	–
Brian May	8/8	4/4	–	3/3	–	4/4
Sara Weller	8/8	–	4/4	3/3	–	–

Actual number of meetings attended   Maximum number of scheduled meetings which the directors could have attended

Code principle – Effectiveness

Introduction by Dr John McAdam

“ Board colleagues have approached the evaluation process with renewed vigour this year, underpinned by the forthcoming challenges of competition and the Lancashire water quality incident. There is a clear message that there is more to do.”

Board evaluation

Our board evaluation was conducted internally this year building on last year’s external evaluation conducted by Lintstock consultants.

The internal evaluation process was facilitated by the company secretary and his team. It was based on the completion of questionnaires by board members assessing both the performance of the board and of each of its principal committees, and that of the Chairman and each of the individual non-executive directors.

In addition to board members, other members of the executive team who regularly attend and support the various committee meetings were asked to complete the same questionnaires where applicable.

The anonymity of all respondents was ensured throughout the process in order to encourage an open and frank exchange of views. The results, once reviewed by the company secretary, were then discussed with the Chairman and the chair of the relevant committee; tabled at a meeting of the relevant committee; and then presented to the board. The Chairman reviewed the performance of the individual directors. Mark Clare, as the senior independent director, in discussion with the other non-executive directors, led the review of the Chairman’s performance.

A summary of the analysis of the 2015/16 evaluation is as follows:

2015/16 Areas of assessment	Commentary and actions
Board composition and expertise	Board members' skills and expertise were felt to be appropriate, and in particular the board members' knowledge and understanding of the regulatory environment the company operates within, along with their understanding of the views of regulators, customers and investors. Additional skills/experience from an engineering/industrial background would strengthen the board.
Board agenda	Given the seriousness of the Lancashire water quality incident it was felt that the considerable board time spent on the issue was appropriate. Going forward, the board should allow time to consider the customer experience, along with the key strategic issues of market reform and competition in the sector.
Board support	Presentations to the board and the timeliness of board documentation were appropriate; improvements had been made to the content, format and length of papers, although this was an area where focus should be kept under review to ensure continued improvement. The support and training needs of board members continued to be addressed.
Wider strategic oversight	The involvement of the board in the development of the strategic direction of the group was considered to be appropriate and the format and content of the board strategy away day held during the year was felt to have improved, but more time should be allowed for key strategic topics.
Risk management and internal control	The board's approach to the management of risk was considered to be appropriate, with suggestions being made to refine the visibility and oversight of the management of operational and reputational risk in light of the Lancashire water quality incident.
Succession planning and human resource management	Board members felt that the senior management structure and succession planning for executive and key management positions supported the strategic objectives. The development of a board succession planning matrix for the board would provide clarity on timescales (see page 65). The visibility of potential internal candidates for succession amongst the executive team should be maintained and enhanced, as should the development of executives and candidates suitable to fulfil critical posts to support the talent pipeline.
Committees	The composition and performance of the audit, remuneration, nomination, corporate responsibility and treasury committees were considered to be appropriate, and the feedback from committee meetings by committee chairs was full and transparent and meetings chaired effectively. Specific actions identified were as follows: Nomination committee: develop a board succession planning matrix and gain an understanding of the granularity of timescales for succession planning; Remuneration committee: ensure that succession planning activities and remuneration activities were aligned; Audit committee: review the effectiveness of the assurance of risk management systems particularly in relation to the oversight of the management of operational and reputational risk; and Corporate responsibility committee: review the analysis of reputational risk to ensure alignment with the audit committee.
Individual directors	The individual performance of the directors was assessed, all of which were considered to be independent and effective, and all directors demonstrated the expected level of commitment to the role. The review of the Chairman's performance (led by the senior independent director) and that of Catherine Bell concluded that both continued to demonstrate an effective and independent approach, fulfil the expected commitment to the role and make an enthusiastic contribution to discussions in meetings. With the exception of Catherine Bell, all directors would be offering themselves for reappointment at the 2016 AGM.

Corporate governance report

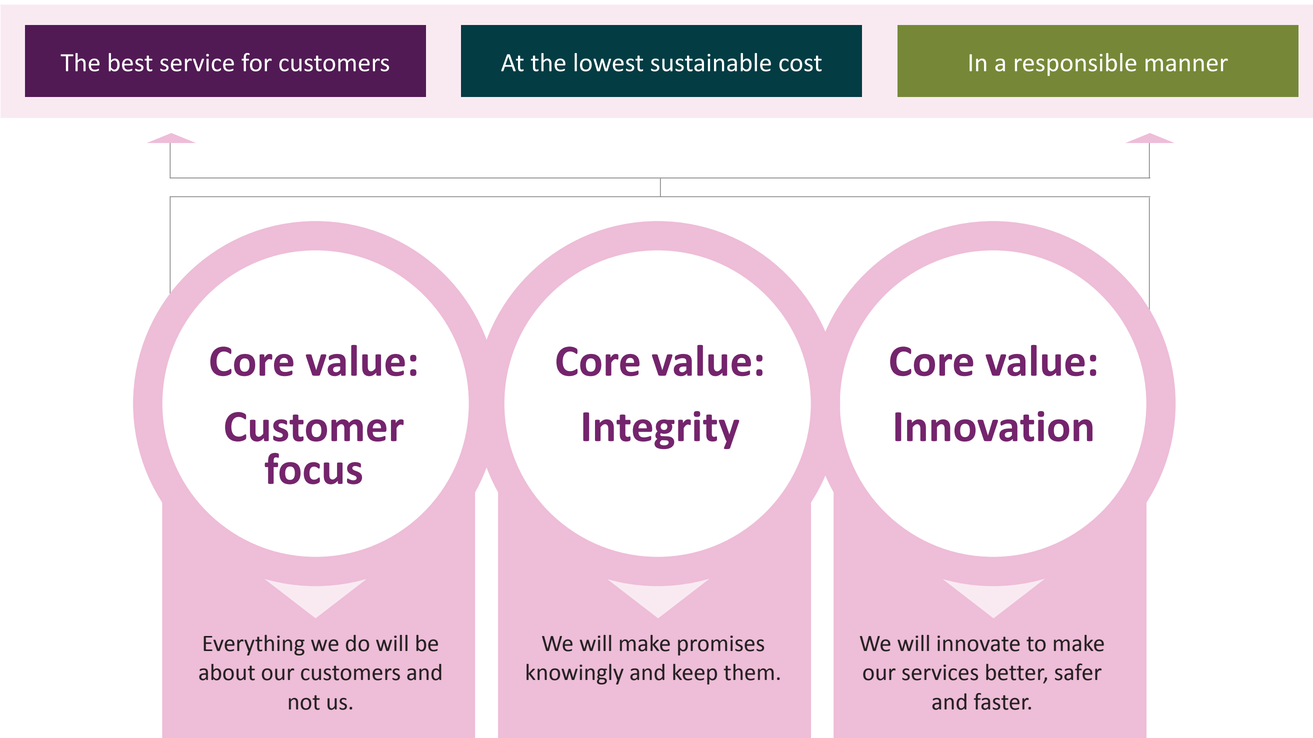
2014/15 evaluation recommendations	Actions taken during 2015/16
On completion of the board's involvement in the PR14 process, allow more time to address market reform and competition.	More board time has been devoted to market reform and competition.
Continued refinement of content and format of board papers.	CEO and CFO monthly board updates and performance reports have been revised and well received.
Consider improvements to the board strategy day.	Format and content of the strategy away day had improved, but still it was felt more time would be preferable. Action to be carried forward.
Maintain and enhance the visibility and engagement by the board with potential candidates for succession and maintain the focus on succession planning for executives and those in critical posts in the talent pipeline.	A number of members of the executive team have given presentations to the board on a number of topics. There were a number of events held during the year where the board has the opportunity to meet with executives and other senior managers.

Training

Directors regularly receive updates to improve their understanding and knowledge about the business and the regulatory environment. Specific training has been provided during the year on a number of areas and topics including regulatory matters and changes in reporting and governance requirements, particularly in relation to the new requirements of the Market Abuse Regulations due to come into force in July 2016.

Culture and values

Our culture is expressed through our core values which support and facilitate the achievement of our strategic objectives. We have made significant progress in improving the customer experience and embedding a customer service orientated culture in recent years. Customer complaints reduced by approximately 75 per cent across the 2010–15 period, and this was recognised in Ofwat's final determination in December 2014. On page 29 of the strategic report, details of the KPIs used to monitor customer service can be found. Our employee surveys (see page 37 of the strategic report) show employee engagement at 75 per cent. Improving customer service and carrying out our activities with integrity and fairness, for all our stakeholders, are interrelated values. The management team are working hard to



embed these values in our business. A customer nomination system has been introduced, enabling customers to nominate employees for 'WOW! Awards' as recognition for a job well done. We have received tremendous feedback, demonstrating the 'extra mile' our employees go to in serving our customers. Furthermore, with the implementation of our 'systems thinking' approach and improving the technology deployed across our asset base during the current regulatory period, we would expect to see further improvements in the standard and efficiency of our service to our customers.

Our business principles can be found on our website at **corporate.unitedutilities.com/united-utilities-business-principles.aspx**

Once published, the board will review the observations of the Financial Reporting Council and its suggestions to boards in promoting good practice in corporate culture.

WOW! Awards

Since we introduced The WOW! Awards scheme in 2012, our employees have been nominated over 10,300 times (as at 31 March 2016), and our employees' efforts have earned United Utilities the most nominations of all the companies involved in the scheme. So far, we have eight employees who have each been nominated 100 times and joined the 100 Club! At the annual awards ceremony in November 2015, Lee Jones, one of our network customer inspectors based at Wilmslow water treatment works, whose tally at the time was 140 nominations, won the award for 'the most inspiring front liner'. Tremendous recognition for Lee, who explains his approach: "I just do what I'm trained to do – it's my job. When you get a WOW! nomination it really brightens up the day and I really appreciate it. It's a great feeling to know a customer is happy with the services we've provided."

At the same ceremony, United Utilities also won two awards: 'Putting Customers First' and 'Empowering Your People'.

The WOW! Awards®
for outstanding customer service...

Corporate governance report
Nomination committee

Dr John McAdam, chair of the nomination committee

To ensure that board members and senior management have the appropriate balance of skills and experience to support the group's strategic objectives.

Quick facts

The Code requires that a 'majority of members of the nomination committee should be independent non-executive directors'

The role of the committee is to make recommendations to the board on its composition, balance and membership and on refreshing the membership of the board committees

The company secretary attends all meetings of the committee

The business services director, who has responsibility for human resources, regularly attends meetings and is responsible for engaging with executive search recruitment advisors

The CEO is not a member of the committee, but from time to time is invited to attend. Neither the Chairman nor the CEO would participate in the recruitment of their own successor

Quick links

Terms of reference – **corporate.unitedutilities.com/corporate-governance**

Nomination committee members

Dr John McAdam (chair)
Dr Catherine Bell
Stephen Carter
Mark Clare
Brian May
Sara Weller

Read the **board of directors'** biographies on pages **52** and **53**

Dear Shareholder

As highlighted by the Financial Reporting Council's (FRC) recently issued discussion paper on UK Board Succession Planning, we have tried to provide a more informative explanation of our succession planning activities. In many ways, given the nature of the subject matter, it is a difficult topic to report publicly, and on a human level, people's lives and circumstances can change, sometimes at short notice.

As a board that is relatively small in size, succession planning to ensure that board members and senior management have the appropriate balance of skills and experience to support the group's strategic objectives is a matter that the board as a whole considers. In accordance with our annual board calendar, we have two related reviews. First, in June when we review the specifics of executive succession planning, and secondly in October as part of the organisational capability review and people plan. All the non-executive directors are members of the nomination committee and are involved in the detailed process of recruitment and consideration of candidates, for both executive and non-executive board appointments. The nomination committee is supported in the recruitment process by Sally Cabrini, business services director, as part of her human resources responsibilities.

Historically, independent non-executive directors at United Utilities have served a term of between seven and nine years, a pattern which has facilitated the refreshing of the board, and also provided a high degree of continuity, and is the pattern that our succession plan for our independent non-executive directors works to. Notwithstanding this, the specifics of each of the non-executive directors' time of departure has been driven by their own personal circumstances. Serving beyond a nine-year term is identified in the Code as being one of the reasons which could affect a non-executive director's independence. The Code excludes board chairmen from the nine-year rule.

Catherine Bell indicated to the board her intention to retire at the AGM in July 2016 and so for the fifth successive year we have undertaken the recruitment process for a new non-executive director, which culminated in the recruitment of Alison Goligher who will join the board with effect from 1 August 2016. The board gender diversity policy is taken into account during every candidate selection process. Ultimately, we do strive to appoint the person we believe is best matched to the role in terms of what they have to offer the company and to make a positive contribution to the board conversation and board dynamics. Diversity of outlook and interest is essential to ensuring we have a different variety of views to contribute to discussions.

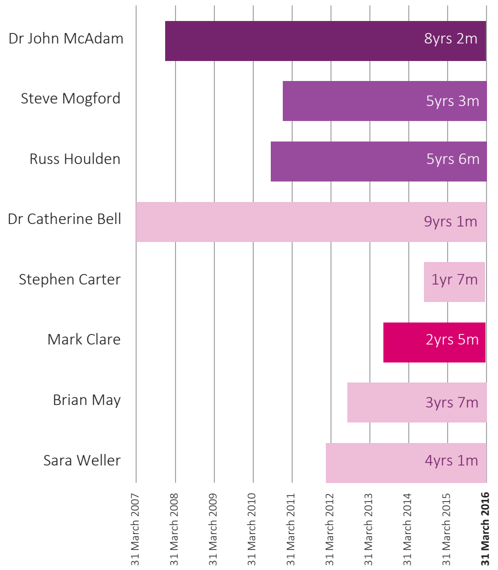
In our succession planning we aim to ensure both our board directors and our senior managers are well equipped with the right skills and experience to address the challenges of our business and in pursuing our strategy and be in tune with the culture of the company. We are mindful of the need to develop our talent pipeline, at all levels throughout the business, so that our employees have the skills and experience to support the long-term needs of our business. We will review the recommendations of the FRC's report on UK Board Succession Planning when available with a view to improving our processes.

Dr John McAdam
Chair of the nomination committee

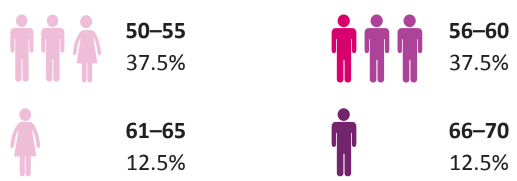
Main responsibilities of the committee

- Lead the process for board appointments and make recommendations to the board about filling vacancies on the board, including the company secretary
- Consider the succession planning of directors and members of the executive team
- Make recommendations to the board on refreshing the membership of the board's principal committees
- Review directors' conflict authorisations
- Consider the request from executive directors for election to the boards of other companies and make a recommendation to the board
- Consider requests from non-executive directors for the election to the boards of other companies; this role has been delegated to the Chairman (other than in respect of his own position)

Directors' tenure as at 31 March 2016



Age profile



What has been on the committee's agenda during the year

1. Board succession

The committee:

- reviewed a draft written succession planning matrix (incorporating the skills matrix) for the board directors as a useful guiding tool to support the long-term planning process for board appointments. The succession planning matrix highlights the Code governance requirements; existing directors' terms of appointment; the projected strategic needs of the business and the resulting preferred experience of any potential new board member and potential successors to a role (where identified) and those who could act as an interim should the need arise;
- with reference to the succession planning matrix, drafted and approved a brief, setting out the attributes and experience of a preferred candidate in light of the needs of the business at this point in the regulatory cycle and to reflect the changes to the business in terms of the increasing competition and the need to strengthen the engineering and industrial capabilities of the board. The brief was issued to a number of executive search consultants to begin the process of the recruitment of a non-executive director. A number of executive search consultants were invited to present their understanding of the brief and their knowledge of the company;

Corporate governance report
Nomination committee

Skills matrix of board directors

	Finance/ accounting	Utilities	Regulation	Government	Construction/ engineering	Industrial	Customer facing	FTSE companies
Dr John McAdam		✓				✓	✓	✓
Steve Mogford		✓			✓		✓	✓
Russ Houlden	✓	✓	✓			✓	✓	✓
Dr Catherine Bell		✓	✓	✓				
Stephen Carter		✓	✓	✓			✓	✓
Mark Clare	✓	✓	✓		✓		✓	✓
Brian May	✓					✓	✓	✓
Sara Weller			✓	✓			✓	✓

- concluded that JCA, who had demonstrated the best understanding of the role, should be appointed to conduct the search. (JCA is a signatory to the voluntary code of conduct on gender diversity for executive search firms; it has no other connection with the group other than being used from time to time for executive search purposes);

Alison Goligher

Alison was appointed in October 2014 as a non-executive director of Meggitt PLC, the engineering group specialising in extreme environment components and smart sub-systems for the aerospace, defence and energy markets. She is a member of the audit, remuneration and nomination committees at Meggitt.

From 2006 to 2015 she worked for Royal Dutch Shell, with her most recent executive role as Executive Vice President Upstream International Unconventionals. Prior to that she spent 17 years of her early career with Schlumberger, an international supplier of technology, integrated project management and information solutions to the oil and gas industry.

She holds a BSc (Hons) Maths and Physics and a MEng in Petroleum Engineering.

- considered and reviewed the long list of candidates and identified those to be shortlisted for interview initially with the Chairman, CEO and the business services director. A number of candidates were then invited to meet with the other non-executive directors and the CFO; and
- discussed the candidates, following feedback from the interview process, and the 'best fit' with the succession planning matrix and the skills matrix (as shown above); took into account the board diversity policy (set out below) and the brief as provided to the executive search consultants; and duly made a recommendation to the board to appoint Alison Goligher as a new non-executive director with effect from 1 August 2016. Alison brings additional industrial and engineering experience to the board, areas of expertise which the board felt could be strengthened (see panel left).

2. Refreshing the membership of the principal committees

Catherine Bell's departure from the board will leave a vacancy on each of the board's principal committees and as chair of the corporate responsibility committee. Stephen Carter will succeed Catherine as chair of the committee. On her appointment on 1 August 2016, Alison Goligher will join the audit, nomination, remuneration and corporate responsibility committees.

3. Board diversity

The board diversity policy is to 'ensure the selection process for board candidates provides access to a 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 diversity'. The identification and recruitment of board members is treated with the utmost importance, meetings are chaired by the Chairman, and all non-executive directors are members of the committee and participate both in meetings and in the recruitment process. As stated by the policy, they are looking for new directors to bring something different to the board table, be it in terms of experience, skills, perspective or interests.

We have retained the 25 per cent gender diversity ratio on our board, in accordance with our board diversity policy.

We are keen to develop our female senior managers so that, over time, they can be considered for executive board appointments or as potential candidates for non-executive directorships in other companies and we have a number of initiatives in place supporting women in the workplace. We encourage our senior managers to take on a non-executive directorship role but recognise that the responsibilities of such a role are very much a personal commitment. During the year, Sally Cabrini, business services director, was appointed as a non-executive director of Lookers plc.

4. Conflicts of interest

The company's articles of association contain provisions which permit unconflicted directors to authorise conflict situations. Each director is required to notify the Chairman of any potential conflict, and the board reviews the position of each director annually. No changes were recorded which would impact the independence of any of the directors.

5. Induction of new non-executive directors

An induction programme is devised for each new non-executive director. It would include one-to-one meetings with the Chairman and each of the existing non-executive directors. They will have one-to-one meetings with the CEO, CFO, managing director of the wholesale business and the company secretary along with other members of the executive team. They will also meet members of the operational teams and visit some of the key operational sites and capital projects to ensure they get a first-hand understanding of the water and wastewater business.

New directors receive a briefing on the key duties of being a director of a regulated water company including the role of the regulated company's holding company, and they will also meet with the director of regulation. They will also meet with representatives of Ofwat.

6. Wider succession and talent management

For a number of years we have had a written succession plan for our executive directors and other members of the executive team, in particular the CEO, CFO, and managing director of wholesale. This plan identifies an interim internal successor to fill the role in the short term should the need arise, and the longer term development needs of potential successors to be able to fulfil the role on a more permanent basis. As with all our board appointments, we would always aim to appoint the best person to fulfil the role. It would be common, when recruiting for a senior role, for an external search to be conducted alongside an internal candidate recruitment process. Any changes that are required to the profile of the management team to reflect the changing needs of the business are considered by the board in the executive succession plan. Succession and development initiatives for senior executives include executive mentoring and international business school training.

During the year, Gary Dixon, customer services director, informed the CEO of his intention to retire at the end of 2016. This has enabled a timely recruitment process to be conducted, culminating in the appointment of an internal candidate, Louise Beardmore, to the role. As part of the handover, Louise initially worked alongside Gary until 1 April 2016 when she took over the full responsibility for customer services. Gary will stay with the business, supporting Louise in this important role until he retires.

Louise Beardmore's promotion to customer services director from 1 April 2016 demonstrates how we have been able to develop our own talent in the organisation. Louise joined the company over 20 years ago and in that time has progressed her career through a variety of roles in operations, customer services and HR. In her last role as head of business transformation, she led all aspects of change and transformation across the company to drive improvements in service and efficiency through people, process and technology changes. At the time of the approval of this report, there were 10 members of the executive team (2015: nine) including the CEO and CFO, with a ratio of six males to four females.

During the year, board directors have a number of opportunities to meet with members of the executive team and those employees at all levels identified as potential talent within the business.

Summary of board diversity policy

- Ensure the selection process for board candidates provides access to a 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 diversity
- 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 is currently to maintain at least 25 per cent female representation

Corporate governance report
Nomination committee

Louise Beardmore, customer services director

Working for the United Utilities group for over 20 years, Louise has held a number of senior positions at North West Water, Norweb, Vertex and United Utilities, leading teams in water operations, customer services and HR. Prior to her new role, Louise was head of business change and organisational development, supporting all aspects of transformational change across the group driving people, process and technology changes to improve service and drive efficiency.

What have we done in 2015/16?

Improving diversity across the talent pool

In our executive team of 10 (including the CEO and CFO), four are women, namely Sue Amies-King (business retail director), Louise Beardmore (who was appointed customer services director on 1 April 2016), Sally Cabrini (business services director) and Gaynor Kenyon (corporate affairs director). We are actively working with these individuals on their personal development plans, which include building their external portfolio.

Women hold 21 per cent of senior leadership positions. For this group, we actively support their individual personal development plans, which includes encouraging them to broaden their external network. Last year our employees set up a self-managed ‘Women in UU’ network. Monthly meetings are held and internal and external speakers are invited to address the group. Membership has trebled during the year. The company will continue to actively support the network over the coming year and provide senior support as required.

Our graduate scheme continues to be successful in attracting female applicants; 26 per cent of applicants were female, and 44 per cent of those appointed were female, while the overall number of female graduates on the scheme is 39 per cent.

In 2015, 30 per cent of our intake of apprentices were female, an increase of five per cent from 2014. Research from the Sector Skills Council for Science, Engineering and Manufacturing Technologies shows the average number of women in apprenticeships is between five and seven per cent. All of our apprentices are supported by a senior manager as part of their career development with us.

We are members of Race for Opportunity, part of Business in the Community and the leading organisation for ethnic diversity and inclusion. In 2015 we participated in the annual benchmarking survey and achieved a bronze award.

Our employee-run lesbian, gay, bisexual and transgender network has organised a number of employee events during the year. Most notable was our presence at the Manchester Gay Pride March in August 2015, where employees were taking part in the parade wearing our company branded clothing and driving a United Utilities branded vehicle.

Code principle – Relations with shareholders

Introduction by Dr John McAdam

"As Chairman, over the course of the year I receive a number of items of correspondence from investment and fund managers and institutional voting agencies. These communications provide useful insight and can act as a stimulus for review and change. They are very much welcomed."

The board as a whole accepts its responsibility for engaging with shareholders and is kept fully informed about information in the marketplace including:

– Makinson Cowell produces an annual survey of investors' views and perceptions about United Utilities, the results of which are presented and discussed by the board;

– the board receives regular updates and feedback on activities within investor relations and reports from sector analysts to ensure that the board maintains an understanding of investors' priorities; and

– the executive and non-executive directors are available to meet with major shareholders and institutional investors; in fact, this is one of the specific roles of the senior independent director.

Institutional investors

We are always keen to hear the views of, and engage with, our shareholders and investors and we have an active investor relations programme. The activities of the programme include:

– a regular schedule of meetings between the CEO and CFO and representatives from our major shareholders. This is also supplemented with meetings hosted by our investor relations team. During the year, the programme covered over 100 institutions based in the UK, Europe, North America and Asia Pacific region;

– presentations by the CEO and CFO to groups of institutional shareholders and investors, both on an ad hoc basis and linked to our half and full year results announcements;

– regular feedback is provided to the board on the views of our institutional investors following on from the CEO and CFO's meetings;

– close contact is also maintained between the investor relations team and a range of City analysts that research United Utilities; and

– in total, we met or offered to meet with 38 per cent by value of the overall shareholder base, which represents 69 per cent of the targetable institutional shareholder base (when adjusting for shareholders who do not typically meet with companies, such as indexed funds).

In meetings with investors, frequent areas of common interest include operational and environmental performance, customer service, capital investment, efficiency initiatives and regulatory outperformance. Investors are always keen to observe financial stability, and investors are interested in the level of gearing versus regulatory assumptions, cost of finance, debt portfolio and maturity profile, future financing requirements and dividends. The outcome of the price review, covering the 2015–20 period, was also a key area of interest for them. Looking ahead, investors will be keen to understand how the company is performing relative to the price review allowances and targets, along with the potential implications of regulatory change and political risk.

Retail shareholders

Despite the privatisation process being over 25 years ago, we have retained a large number of individual shareholders with registered addresses in the North West of England – in fact around 41 per cent. We have historically always held our AGM in our region in Manchester, which enables our more local shareholders, many of whom are also our customers, to attend the meeting. We endeavour to hold the meeting at a venue which is both centrally located in the city (to enable shareholders to use public transport should they so wish) whilst being mindful of the costs.

There is a considerable amount of information on our website, including our online report which provides information on our key social and environmental impacts and performance during the year. Together with the annual and half-yearly results announcements, our annual report and financial statements are available on our website; these are the principal ways in which we communicate with our shareholders. Our company secretariat and investor relations teams, along with our registrar, Equiniti, are also on hand to help our retail shareholders with any queries. Information for shareholders can also be found on the inside back cover of this document, with a number of useful website addresses.

Corporate governance report

Relations with other providers of capital

Running a water and wastewater business, by its very nature, requires a long-term outlook. Our regulatory cycle is based on five-year periods, and we raise associated funding in order to build and improve our water and wastewater treatment works and associated network of pipes for each five-year cycle. We are heavily reliant on successfully acquiring long-term funding from banks and debt capital markets to fund our capital investment programme.

This requires a long-term support from our credit investors who invest in the company by making term funding available in return for receiving interest on their investment. We arrange term debt finance in the bond markets (with maturities typically ranging from seven years to up to 50 years at issue). Debt finance is raised via the group's London listed multi-issuer Euro Medium Term Note Programme, which gives us access to the sterling and euro public bond markets and privately arranged note issues. Committed credit facilities are arranged with our relationship banks on a bilateral basis. Additionally, the European Investment Bank (EIB), which is the financing arm of the European Union, is our single biggest lender, currently providing over £2 billion of debt and undrawn facilities to support our capital investment programmes (past and present). The group currently has gross borrowings of £6,978 million.

Given the importance of debt funding to our group, we have an active credit investor programme coordinated by our group treasury team, which provides a first point of contact for credit investors' queries and maintains a dedicated area of the company's website. One-to-one meetings are held with credit investors through a programme aimed at the major European fund managers known to invest in corporate bonds that may be existing holders of the group's debt or potential holders. Regular mailings of company information are sent in order to keep credit investors informed of significant events. The treasury team has regular dialogue with the group's relationship banks and the EIB. More information can be found on our website at **corporate.unitedutilities.com/93.aspx**

Code principle – Accountability

Introduction by Dr John McAdam

"We engaged the services of a risk management consultancy following the Lancashire water quality incident, as part of the internal investigation into the incident to assess whether our existing risk management framework was fit for purpose in identifying and assessing risk and whether the risk management framework was being used effectively."

Board's approach to risk management and internal control

The board is responsible for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The board is also responsible for ensuring that the company's risk management and internal control systems are effectively managed across the business and that they receive an appropriate level of scrutiny and board time. The group's risks predominantly reflect those of all regulated water and wastewater companies. One of the most significant risks is that of failing to achieve our regulatory performance targets or failing to fulfil our obligations in any five-year planning cycle, leading potentially to the imposition of fines and penalties. 2015/16 has been the first year of our current five-year planning cycle, and in terms of our capital programme we have had a smooth start.

During the year, the board engaged an independent review of the effectiveness of the risk management framework as part of the internal investigation led by the Senior Independent Director of the Lancashire water quality incident. The independent review concluded that the risk management framework was robust and reflected best practice and there was active engagement with risk management by senior management, the executive team and the board but could be strengthened. The recommendations of this internal investigation included: the need for centralisation of the drinking water safety plans within wholesale to aid consistency; improved application of the risk management process; further embedding existing risk management processes within wholesale and improving system integration; and increasing the focus on reputational and operational risks.

The board, following the review by the audit committee, concluded that it was appropriate to adopt the going concern basis of accounting (see page 122). Similarly, in accordance with the principles of the Code, the board concluded, following a recommendation from the audit committee, that it was appropriate to provide a long-term viability statement (see page 71). Assurance supporting these statements was provided by the review of: the group's key financial measures; the key credit financial ratios; the group's liquidity and UUW's ongoing ability to meet its financial covenants; and the contingent liabilities of the group.

As part of the assurance process, the board also took into account the principal risks and uncertainties facing the company, and the actions taken to mitigate those risks. These principal risks and uncertainties are detailed on pages 48 and 49, as are the risk management processes and structures used to monitor and manage them. Biannually, the board receives a report detailing management's assessment of the most significant risks facing the company. The report gives an indication of the level of exposure, subject to the mitigating controls in place, for the risk profile of the group. The board also receives information during the year from the treasury committee (to which the board has delegated matters of a treasury nature – see the structure diagram on page 58) including such matters as liquidity policy, the group's capital funding requirements and interest rate management.

Review of the effectiveness of the risk management and internal control systems

Taking into account the information on principal risks and uncertainties provided on pages 48 and 49, and the ongoing work of the audit committee in monitoring the risk management and internal control systems on behalf of the board (and for whom the committee provides regular updates, see pages 78 and 79), the board:

- is satisfied that it has carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; and
- has reviewed the effectiveness of the risk management and internal control systems including all material financial, operational and compliance controls (including those relating to the financial reporting process) and no significant failings or weaknesses were identified. After review, it was concluded that through a combination of the work of the board, the audit committee and the UUW board (with specific responsibility for operational and compliance controls), the company's risk management and internal controls were indeed effectively monitored throughout the year.

In the review of the effectiveness of risk management and internal controls systems the board also took into account the:

- biannual review of significant risks;
- oversight of treasury matters;
- reviewing and assessing the activities of internal audit;
- reviewing management's internal control self-assessment;
- reviewing reports from the group audit and risk board;
- reviewing the outcome of annual business unit risk assessment process; and
- reviewing the business risk management framework supported by the work of the independent reviewer.

Long-term viability statement

The directors have assessed the viability of the group, taking account of the group's current position, the potential impact of the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions. Based on this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the five-year period to March 2021.

Read our **Principal risks and uncertainties** on pages **46** to **49**

This statement has been based upon the group's strategic planning process, which is aligned to the price control period and the group's robust capital solvency position with a debt to RCV ratio of around 60 per cent, providing considerable capital headroom and supporting any increase in medium-term liquidity if required. The group has a proven track record of being able to raise new forms of finance in most market conditions, and expects to continue to do so into the future. In addition, the board has considered the protections which exists from the regulatory and economic environment within which it operates. From an economic perspective, given the nature of water and wastewater services, threats to the group's viability from risks such as reduced market share, substitution of services and reduced demand are low compared to those faced by many other industries. From a regulatory perspective the group benefits from a rolling 25-year licence which, coupled with the price control set by Ofwat, provides a high degree of certainty of cash flows during the current price control period (which runs to March 2020), while between price control periods there exists additional protection afforded by Ofwat's primary legal duty to ensure that water and wastewater companies are able to finance their functions. For these reasons the board considers it appropriate to provide a medium-term viability statement of five years.

The directors have assessed the group's viability considering the principal risks as set out on pages 48 to 49, and its ability to absorb a number of severe but reasonable scenarios, taking into account those event-based risks assessed to have the highest possibility of occurrence and the most severe impact. These include political and regulatory risks, as well as the potential for a restriction to the availability of financing resulting from a global capital markets crisis. The viability assessment has considered the potential impacts of these risks on the group's business model, future performance, solvency and liquidity over the period. As well as the protections which exist from the regulatory environment within which it operates, a number of mitigating actions are available in the extreme scenarios considered, including the restriction of dividend payments. These actions provide the group with significant scope to improve its liquidity and capital position to further absorb such threats.

The directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the basis of preparation paragraph on page 122.

Code principle – Remuneration

Introduction by Dr John McAdam

"Our remuneration policy has been designed in order to promote the long-term success of the company and delivery of the business strategy, with a significant proportion of senior executives' pay being performance related."

Read the **Remuneration committee report** on pages **82** to **101**

Corporate governance report
Audit committee

Brian May, chair of the audit committee

Much of the work of the committee is necessarily targeted at the regulated activities of UUW, which represent over 98 per cent of group revenues.

Quick facts

- Brian May has chaired the committee since July 2013. He is a serving finance director of a FTSE 100 company and chartered accountant and is considered by the board to have recent and relevant financial experience
- Other regular attendees at meetings include the Chairman, the CEO, the CFO, the company secretary, the head of audit and risk, the group controller, and representatives from the external auditor KPMG LLP (KPMG)
- KPMG and the head of audit and risk both have time with the committee to raise freely any concerns they may have without management being present
- The committee is authorised to seek independent advice as it sees fit, but has not done so during the year

Quick links

Terms of reference – **corporate.unitedutilities.com/corporate-governance**

FRC Audit Quality Inspection Report 2015 – frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit Quality-Inspections-Annual-Report-2014-15.pdf

Audit committee members

Brian May (chair)
Dr Catherine Bell
Stephen Carter

Read the **board of directors'** biographies on pages **52** and **53**

Dear Shareholder

This year we are reporting fully against the 2014 Code, and the terms of reference of the committee have been amended accordingly. Both the Code and the Competition and Market Authority's Statutory Audit Services Order (the Order)* cites the responsibility for the process and implementation of auditor appointment to rest with the audit committee and that FTSE 350 companies should put the external audit contract out to tender at least every 10 years.

Notwithstanding the mandatory 10 year rule, the Order requires that a company, that has not competitively tendered its audit services contract in the previous five years, should explain in the fifth (and subsequent years) why this is in the best interests of the company's shareholders. A tender process for statutory audit services was last conducted in 2011, resulting in a change of auditor. KPMG commenced their appointment as auditor and presented their first report to shareholders for the year ended 31 March 2012. The committee has reviewed the auditor appointment, as the 2016 year end audit has been KPMG's fifth consecutive year in office as statutory auditor. The committee concluded that it was in the best interests of shareholders not to competitively tender the statutory audit at this time given the satisfactory performance of KPMG throughout their current tenure, and the need for the auditor to be familiar with the business throughout the period leading up to the next price review in 2019. Furthermore, given 2015/16 is KPMG's fifth year as auditor, the lead audit partner will rotate for the year ended 31 March 2017. In accordance with the Order, the matter will be kept under review and reported upon annually, but it is the current intention that a competitive tender would next be conducted for the financial year ended 31 March 2022. United Utilities has complied fully with the provisions of the Order for the year ended 31 March 2016. Further information can be found on page 76.

Although audit committees have specific responsibilities rooted in reviewing the group's financial statements and reviewing the internal assurance work and external audit of those financial statements, the committee also reviews the internal control and risk management processes, leaving the review of the significant risks to be undertaken by the board. During the year, the board engaged an independent review of the business risk management framework which was considered to be satisfactory but recommended a number of actions to enhance the process (see page 70). A long-term viability statement was first published in our 2015 annual report; the processes of assurance supporting our 2016 statement have been considered and enhanced (see page 71).

Much of the work of the committee is necessarily targeted at the regulated activities of UUW, which represent over 98 per cent of group revenues and is a reflection of our commitment to safeguarding the interests of our customers.

We express our thanks to Catherine Bell, who is stepping down from the board and the committee at the AGM, for her valuable contribution, and look forward to working with Alison Goligher when she takes up her appointment and joins the committee.

We have again worked to enhance this report and make it more informative for the reader and we continue to be committed to providing meaningful disclosure of the committee's activities. As chair of the audit committee, I am committed to ensuring that the committee's agenda is kept under review and keeps abreast of relevant developments.

The following report was approved by the committee at its meeting held on 18 May 2016.

Brian May
Chair of the audit committee

* The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Main responsibilities of the committee

- Make a recommendation to the board for the appointment or reappointment of the auditor, and to be responsible for the tender of the audit from time to time and to agree the fees paid to the auditor
- Establish policies for the provision of any non-audit services by the auditor
- Review the scope and the results of the annual audit and report to the board on the effectiveness of the audit process and how the independence and objectivity of the auditor has been safeguarded
- Review the half-year and annual financial statements and any announcements relating to financial performance, including reporting to the board on the significant issues considered by the committee in relation to the financial statements and how these were addressed
- Review the scope, remit and effectiveness of the internal audit function and the group's internal control and risk management systems
- Review the group's procedures for whistleblowing, reporting fraud and other inappropriate behaviour and to receive reports relating thereto
- Report to the board on how it has discharged its responsibilities

Corporate governance report
Audit committee

What has been on the committee's agenda during the year

The committee has an extensive agenda of items of business which it deals with in conjunction with senior management, the auditor, the internal audit function and the financial reporting team. There were four scheduled meetings of the committee during the year. Items of business considered by the committee during the year included:

- considering the issues and findings brought to the committee's attention by the internal audit team and satisfying itself that management has resolved or is in the process of resolving any outstanding issues or concerns;
- reviewing the assurance work undertaken by internal audit relating to: the content of the regulatory business plan and the processes supporting the preparation of the plan; and the annual regulatory reports;
- reviewing the reports from the financial reporting team on the financial statements, including the UUW financial statements and other regulatory reports, and considering matters such as the accounting judgements and policies being applied;
- reviewing the proposed audit strategy for the 2015/16 statutory audit, including the level of materiality applied by KPMG, audit reports from KPMG on the financial statements and tasking management to resolve any issues relating to internal controls and risk management systems;
- reviewing the going concern and longer term viability assessments prior to making its recommendations to the board and the assurance provided in undertaking the viability assessment;
- an annual review and approval of the policy on non-audit services provided by the auditor including the continued use during 2015/16 of Makinson Cowell (a subsidiary of KPMG) and the services provided by other accounting firms to the group during the year;
- reviewing the need for, and timing of, the tender for statutory audit services;
- monitoring incidents of whistleblowing and fraud reporting;
- biannual oversight and monitoring of the group's compliance with the Bribery Act which the board reviews annually;
- overseeing and approving the strategic internal audit planning approach and reviewing reports on the work of the internal audit function from the head of audit and risk. A new system of grading for internal audit reports was introduced during the year;
- an externally facilitated review of the business risk management framework was commissioned by the board in response to the Lancashire water quality incident;
- reviewing the requirements and implications for United Utilities of the European Union Audit Directive and Audit Regulation as published in May 2014 and due to come into force in the UK from 17 June 2016;
- reviewing the quality and effectiveness of internal audit; and
- reviewing the committee's terms of reference and the conclusions of the committee's annual evaluation. The internally facilitated evaluation was undertaken as part of the overall board evaluation (see page 61). The review explored: time management and the composition of the committee; the committee's processes and support; and the agenda and work of the committee. It was concluded that the committee was effective.

How we assessed whether 'the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'

The committee, further to the board's request, has reviewed the annual report and financial statements with the intention of providing advice to the board on whether, as required by the Code, 'the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'.

To make this assessment, all members of the committee received copies of the annual report and financial statements to review during the drafting process to ensure that the key messages being followed in the annual report were aligned with the company's position, performance and strategy being pursued; and that the narrative sections of the annual report were consistent with the financial statements. The significant issues considered by the committee in relation to the financial statements were consistent with those identified by the external auditor in their report on pages 112 to 115.

The visual presentation of the company's business model (on page 12) has been reformatted to make it more understandable for the reader and there are clear linkages to the company's strategic objectives throughout the document.

The committee concluded that the key performance indicators (KPIs) included in the strategic report (see pages 28 and 29) were, amongst others, those used by management and reflected the measures to be monitored by Ofwat during the 2015–20 period.

In addition, the committee was satisfied that all the key events and issues which had been reported to the board in the CEO's monthly report during the year, both good and bad, had been adequately referenced or reflected within the annual report.

How we assessed the effectiveness of the external audit process

The committee, on behalf of the board, is responsible for the relationship with the external auditor, and part of that role is to examine the effectiveness of the audit process.

Audit quality is a key requirement. Prior to the statutory audit, at the half-year, KPMG presented the strategy and scope of the audit for the financial year, highlighting any areas requiring special consideration. KPMG then reported against this audit scope at subsequent committee meetings.

On completion of the audit at the full-year, all members of the committee, as well as key members of the senior management team and those who regularly provide input into the audit committee or have regular contact with the auditor, were required to complete a questionnaire seeking their views on how well KPMG performed the year-end audit. Views of the respondents were sought in respect of: the robustness of the audit process; the quality of the delivery of the audit; the expertise of the audit team conducting the audit and that the degree of professional scepticism applied by the auditor was appropriate; the appropriateness of the communication between the committee and the auditor in terms of technical issues; the quality of the service they gave; and their views on the quality of the interaction between the audit partners, audit manager and the company. The feedback was collated and presented to the committee's meeting in November 2015, at which the conclusions were discussed and any opportunities for improvement brought to the attention of the external auditor.

Private meetings are held at each committee meeting between the audit committee and the representatives of the external auditor without management being present in order to encourage open and transparent feedback by both parties.

The committee concluded that the overall external audit process and services provided by KPMG were satisfactory and effective.

How we assessed the independence of our external auditor

There are two aspects to auditor independence that the committee monitors.

First, in accordance with the Auditing Practices Board Ethical Standards, KPMG has to implement rules and requirements such that none of its employees working on our audit can hold any shares in United Utilities Group PLC. KPMG is also required to tell us about any significant facts and matters that may reasonably be thought to bear on its independence or on the objectivity of the lead partner and the audit team. The lead partner must change every five years and the quality review partner, who reviews the judgements of the audit team actually doing the audit, rotates every seven years along with the key audit partner.

Secondly, the committee considers and approves all the fees that it pays for audit, audit-related and non-audit services from KPMG. KPMG is prohibited from providing certain services to the group, such as operational consulting, internal audit services and strategic planning support, as it is felt that these types of services could impede their independence. Furthermore, auditor independence is also safeguarded by limiting the value of non-audit services performed by the external auditor, which should not ordinarily exceed 100 per cent of the audit fee. The committee has discretion in exceptional circumstances or where a compelling commercial justification can be provided for this cap on non-audit fees to be exceeded. The CFO can pre-approve expenditure in respect of non-audit services, such as tax compliance work, of up to £100,000. Thereafter, any fees for non-audit services up to 100 per cent of the audit fee cap can be approved by the committee chair. Any such fees are reported to the committee for review.

For a number of years, the group has engaged the consultancy firm Makinson Cowell to provide it with investment research and advice. As reported in the 31 March 2014 annual report, Makinson Cowell was acquired by KPMG in June 2013; therefore, the fees paid to Makinson Cowell are included in the total of 'other non-audit services' paid to KPMG (see the bar chart on page 76). As part of the annual review by the committee of the non-audit services policy the engagement of Makinson Cowell was considered. The committee took into account the board's satisfaction with the services provided by Makinson Cowell and concluded that it was appropriate for their services to be retained for the year ended 31 March 2016. The committee will review its policy and the content of the company's list of non-audit services that the statutory auditor is not able to provide when the outcome of the FRC's consultation on the implementation of the EU Audit Directive and Audit Regulation becomes available, which applies to financial years starting on or after 17 June 2016.

As part of UUW's licence conditions it is required to prepare audited regulatory accounts, which are derived from the statutory financial statements. Given the audit of the statutory financial statements is already undertaken by KPMG, there are efficiencies and cost savings if KPMG also audits the regulatory accounts. Fees paid to KPMG also include audit-related services in relation to UUW regulatory assurance work as shown in the bar chart on page 76.

Taking into account our findings in relation to the effectiveness of the audit process and in relation to the independence of KPMG, the committee was satisfied that KPMG continues to be independent, and free from any conflicting interest with the group. As a result, the committee recommended to the board that KPMG be proposed for reappointment at the forthcoming AGM in July 2016. There are no contractual obligations that restrict the committee's choice of external auditor and no auditor liability agreement has been entered into.

Corporate governance report
Audit committee

Fees paid to KPMG (£'000)

Notes:
(1) The fees paid to KPMG for statutory audit services were higher in 2015 than the prior year reflecting the additional work required due to the restatement of UUW's prior year financial statements on adoption of IFRS during 2014/15.
(2) The fees paid to KPMG for other non-audit services were higher in 2015 than the prior year reflecting the additional work that KPMG undertook relating to the price review submission. KPMG Consulting was identified as one of the few firms with the capability to undertake the work required within the extremely tight timescales required.
(3) The fees paid to KPMG for statutory audit-group and company fees were higher in 2016 than the prior year due to the additional work relating to the joint venture with Severn Trent.
(4) The fees paid to KPMG for regulatory reporting and assurance were higher in 2016 than the prior year reflecting the new regulatory reporting requirements of the 2015–20 period.
(5) The fees paid to KPMG for audit-related services in 2016 were higher than the prior year to reflect agreed upon procedures on the new Ofwat performance report.

Audit tender

The Order (see page 72) promotes audit tendering every five years through a 'comply or explain' requirement with mandatory tendering after 10 years. It is the responsibility of the committee to undertake such a review.

As part of its audit tender review, the committee took into consideration, amongst other things, audit quality, auditor independence, the cost of the audit and the likely cost and time involved in a tender process. It also reviewed when the most appropriate point in the regulatory cycle would be to conduct an audit tender, given the benefits of having an experienced audit team in place in the run-up to the next price determination.

The committee's view was that the quality of the audit received from KPMG was satisfactory. This view was informed by the review of the effectiveness of the external audit process (see page 75) and by reference to the FRC's May 2015 Audit Quality Inspection report of KPMG and its peers (see website address on page 72). It was concluded that KPMG demonstrated an independent approach and operated in accordance with the Ethical Standards of the Auditing Practices Board ('APB ethical standards', see page 75). In accordance with APB ethical standards, the lead audit partner must change every five years. As a result, the lead audit partner will be replaced for the 2016/17 financial statements with a partner with relevant audit experience of other FTSE 100 utility companies. Furthermore, the committee agreed that the fee charged for auditing services was competitive and represented value for money, and that it would not be efficient use of the committee's time, nor associated cost to the company, to conduct a tender process for the audit services contract.

The committee concluded that it is the current intention that a competitive tender would next be conducted for the financial year ended 31 March 2022.

Significant issues considered by the committee in relation to the financial statements and how these were addressed

In relation to the group's financial statements, the committee reviewed the following principal areas of judgement (as noted in the accounting policies):

Capitalisation of fixed assets

Fixed assets represent a subjective area, particularly in relation to costs permitted for capitalisation and depreciation policy.

- The committee reviewed the recovery of the capital overhead rate which management has applied during the year and which the committee had approved in the previous year for the next five-year regulatory period. The capital overhead rate historically has been established at the commencement of each five-year regulatory period and is applied as a percentage of capital expenditure to charge certain capital overhead costs to capital projects. Management reported the forecast recovery across the five-year period based upon budgeted capital expenditure and demonstrated that the rate still remained appropriate.

Revenue recognition and allowance for doubtful receivables

Due to the nature of the group's business, the extent to which revenue is recognised and doubtful customer debts are provided against is an area of considerable judgement and estimation.

- The committee reviewed the current levels of doubtful debt and credit note provisioning (see note 14 for more detail). The committee challenged management over the adequacy of the overall levels of provisioning following these reviews and was satisfied that the resulting net debtor balance was appropriate.

Provisions and contingencies

The group makes provisions for contractual and legal claims which by their nature are subjective and require management to arrive at a best estimate as to the probable outcomes and costs associated with each individual case.

- The committee received regular updates on new and existing claims being made against the group and the extent to which these have been provided for (see note 20 for details). The committee focused its attention on the more significant items and discussed the judgements made by management in arriving at appropriate provisions in relation to these matters.
- Based upon the facts behind each provision and taking account of any relevant legal advice that may have been received as well as the past experience of management in making such provisions and challenging where necessary the views taken by management and through the assurance provided by KPMG who cover these as part of their audit, the committee concluded that the provisions management had made were appropriate.

Retirement benefits

The group's defined benefit retirement schemes are an area of considerable judgement and the performance and position of which is sensitive to the assumptions made.

- The committee reviewed the methodology and assumptions used in calculating the defined benefit scheme surplus (see note A5 for more details). The group employs the services of an external actuary to perform these calculations and determine the appropriate assumptions to make. KPMG presented a report showing how the assumptions applied compared to their client base. After considering the above, the committee concluded that the approach taken and assumptions made were appropriate and fairly balanced in determining the net retirement benefit surplus.
- The committee sought from management an understanding as to the factors which led to the significant increase in the IAS 19 net retirement benefit surplus during the period and noted that the scheme specific funding basis had not been impacted by this volatility. Management presented an explanatory note (see page 151) in order to communicate most effectively what is a complex area for the benefit of the group's stakeholders. The committee was satisfied with the explanations provided by management.

Derivative financial instruments

The group has a significant value of swap instruments, the valuation of which is based upon models which require certain judgements and assumptions to be made. Management performs periodic checks to ensure that the model derived valuations agree back to third party valuations and KPMG checks a sample against its own valuation models. It was confirmed to the committee that such testing had been undertaken during the year and there were no significant issues identified.

Taxation

The committee considered the tax risks that the group faces and the key judgements made by management underpinning the provisions for potential tax liabilities and deferred tax assets. In addition, the committee took account of KPMG's assessment of these provisions. Based upon the above, the committee was satisfied with the judgements made by management.

Underlying operating profit adjustments

During the year the committee considered and challenged management's treatment of items as adjustments to underlying operating profit which resulted in management enhancing and further clarifying its existing policy in this area. The committee approved management's revised policy on underlying operating profit adjustments and satisfied itself that those items being reported as adjustments met the requirements of the revised policy. A summarised version of the policy is shown on page 28.

Corporate governance report
Audit committee

The main features of the group's internal controls and risk management systems are summarised below:

a. Internal audit function

The internal audit function is a key element of the group's corporate governance framework. Its role is to provide independent and objective assurance, advice and insight on governance, risk management and internal control to the audit committee, the board and to senior management. It supports the organisation's vision and objectives by evaluating and assessing the effectiveness of risk management systems, business processes and key internal controls.

In addition to reviewing the effectiveness of these areas and reporting on aspects of the group's compliance with them, internal audit makes recommendations to address any key issues and improve processes. Once any recommendations are agreed with management, it monitors their implementation and reports to the committee on progress made at every meeting.

A five-year strategic audit planning approach has been developed and adopted during the previous year. This now facilitates a more efficient deployment of internal audit resource in providing assurance coverage over time across the whole business, as well as greater variation in the nature, depth and breadth of audit activities. Following approval by the audit committee, this strategic approach supports the annual audit plan, which is then endorsed by management, and which the committee also approves. The plan focuses the team's work on those areas of greatest risk to the business. Building on the strategic planning approach, the development of the plan considers risk assessments, issues raised by management, prior audit findings and a cyclical review programme. The in-house team is expanded as and when required with additional resource and skills sourced from external providers – primarily PwC at present. The committee keeps the relationship with PwC under review to ensure the independence of the internal audit function is maintained. In the course of its work, the internal audit function also liaises with the statutory auditor, discussing relevant aspects of their respective activities which ultimately supports the assurance provided to the audit committee and board.

The effectiveness of the internal audit function's work is continually monitored using a variety of inputs including the ongoing audit reports received, the audit committee's interaction with the head of audit and risk, an annual review of the department's internal quality assurance report, annual stakeholder surveys in which committee members also participate as well as any other periodic quality reporting requested. In addition, during 2015, the quality and effectiveness of the internal audit function was externally assessed. Following this assessment, the committee concluded that the internal audit function was effective and appropriate resources were available as required.

Internal audit, led by the head of audit and risk, covers the whole of the group's activities and reports to the committee and functionally to the CFO. The head of audit and risk attends all scheduled meetings of the audit committee, and has the opportunity to raise any matters with the members of the committee at these meetings without the presence of management. He is also in regular contact with the chair of the committee outside of the committee meetings.

b. Risk management systems

The committee receives updates and reports from the head of audit and risk on activities relating to the company's risk management systems and processes at every meeting. These are then reported to the board, as appropriate. The group designs its risk management activities in order to manage rather than eliminate the risk of failure to achieve its strategic objectives.

The CFO has executive responsibility for risk management and is supported in this role by the head of audit and risk and the corporate risk manager and his team. The group audit and risk board (GARB) is a sub-committee of the executive team. The GARB meets quarterly and reviews the governance processes and the effectiveness and performance of these processes along with the identification of emerging trends and themes within and across the business. The work of the GARB then feeds into the information and assurance processes of the audit committee and into the board's assessment of risk exposures and the strategies to manage these risks.

Supplementing the more detailed ongoing risk management activities within each business area, the annual business unit risk assessment process (BURA) seeks to identify how well risk management is embedded across the different teams in the business. The BURA involves a high level review of the effectiveness of the controls that each business unit has in place to mitigate risks relating to activities in their business area, to encourage the identification of new and emerging risks and generally to facilitate improvements in the way risks are managed. The outcome of the BURA process is communicated to the executive team and the board. This then forms the basis of the determination of the most significant risks that the company faces which are then reviewed by the board. During the previous year, new risk management software was developed and has now been implemented across the business to further enhance the company's risk management process.

In addition, during 2015/16, the quality and effectiveness of the risk management process was externally assessed. The external assurance was sought as part of the internal investigation of the Lancashire water quality incident. The scope of the assessment examined whether the existing risk management framework was effective in identifying and assessing risk; whether employees (as appropriate) have the necessary capabilities, knowledge and resource to use the risk management processes effectively; and whether the mitigation and management of risk at a strategic and tactical level were effective.

The independent review concluded that the risk management framework was robust and reflected best practice and there was active engagement with risk management by senior management, the executive team and the board but could be strengthened. Following this assessment, the board will be responsible for ensuring that the recommendations are implemented including: the need for centralisation of the drinking water safety plans within wholesale to aid consistency; improved application of the risk management process; further embedding existing risk management processes within wholesale and improving system integration; and increasing the focus on reputational and operational risks.

c. Internal controls

The committee reviews the group's internal control systems and receives updates on the findings of internal audit's investigations at every meeting, prior to reporting any significant matters to the board. Internal control systems are part of our 'business as usual' activities and are documented in the company's internal control manual which covers financial, operational and compliance controls and processes. Internal control systems are the responsibility of the CFO, with the support of the GARB, the financial control team and the internal audit team, although the head of audit and risk and his team are directly accountable to the audit committee.

Confirmation that the controls and processes are being adhered to throughout the business is the responsibility of managers, but is continually tested by the work of the internal audit team as part of its annual plan of work which the committee approves each year as well as aspects being tested by other internal assurance providers. Compliance with the internal control system is confirmed annually by the completion of a self-assessment checklist by senior managers in consultation with their teams. The results are then reviewed and audited on a sample basis by the internal audit team and reported to the committee.

Corporate governance report
Corporate responsibility committee

Dr Catherine Bell, chair of the corporate responsibility committee

Quick facts

- The committee comprises three directors appointed by the board, two of whom are independent non-executive directors
- The company secretary attends all meetings of the committee
- The corporate affairs director, who has responsibility for company reputation, and the business services director, who has responsibility for human resources, regularly attend meetings
- Senior operational managers attend the committee to report on the environmental and social impact of major investment programmes and projects
- The corporate responsibility committee has existed for over seven years

Quick links

Terms of reference – **corporate.unitedutilities.com/corporate-governance**

Corporate responsibility members

Catherine Bell (chair)
Stephen Carter
Steve Mogford

Read the **board of directors'** biographies on pages **52** and **53**

Dear Shareholder

I am pleased to report on the corporate responsibility committee's (CRC) key areas of focus over the past 12 months.

For some time, the CRC has been taking a close look at the critical factors in building trust and confidence with customers and other stakeholders over the long-term. This was brought into sharp focus following the Lancashire water quality incident in summer 2015 (see case study, page 32) and the December 2015 winter floods in Cumbria, Lancashire and Greater Manchester (see case study, page 35).

The committee closely examined the independent research and other views gathered about the water quality incident and how it was handled. The CRC considered how the company had understood customer views and factored these into its response. The committee was pleased to note specific actions in relation to those customers considered as vulnerable, or with additional needs, as well as support for Lancashire community groups. At the time of writing, with the DWI report yet to be published, it remains the case that longer-term customer views are contingent on the outcome of the ongoing investigation.

Following the winter floods, the CRC examined how the company responds to flooding and resilience risks. The committee will return to this regularly given the pending government and regulators' reviews of resilience, and importance of setting the right framework for investment decisions.

More broadly, the committee continued to monitor the company's progress in delivering its objectives to provide the best service to customers, at the lowest sustainable cost, in a responsible manner. I can report that over 75 per cent of the stretching targets, tracked by the committee to measure the company's CR performance, were achieved by the end of the 2010–2015 investment period.

As delivery of the 2015–2020 plan gathers momentum, the committee discussed how the CR agenda and United Utilities' strategic intentions for the next five years should be aligned. The CRC approved a new, challenging corporate responsibility scorecard for 2015–2020, recognising the importance of setting targets for the long term and providing transparency to employees and external stakeholders on the company's responsible business performance. Progress will be reported on the company's website.

In reviewing progress, the CRC considered a wide range of topics. These included cross-cutting themes such as governance, reputation, communication, stakeholder engagement and performance reporting through to specific topics such as diversity and inclusion, priority customers, carbon mitigation and community investment.

The CRC encourages the company's use of independently and externally assessed national and international benchmarks to measure its responsible business performance. The committee is again delighted that the company has retained 'World Class' status in the Dow Jones Sustainability index for the eighth consecutive year and, for the second consecutive year, leads the multi-utility and water sector. The company also performed strongly in the Carbon Disclosure Project, scoring over 97 per cent.

I have found it a real privilege to oversee the company's responsible business agenda for the past seven years. As I prepare to hand over chairmanship of the CRC to Stephen Carter, I know that he will ensure it continues to champion this topic on behalf of the board. Acting responsibly helps United Utilities to be a successful long-term business for both shareholders and customers. I wish Stephen, and the company, every success.

Dr Catherine Bell
Chair of the corporate responsibility committee

Main responsibilities of the committee

The board approved a modified set of terms of reference for the CRC in April 2016. The main duties are to:

– Consider and recommend to the board the broad corporate responsibility (CR) policy taking into account the company's desired CR positioning

– Keep under review the group's approach to CR and ensure it is in alignment with the group strategy

– Review CR issues and objectives material to the group's stakeholders and identify and monitor the extent to which they are reflected in group strategies, plans and policies

– Monitor and review the status of the company's reputation and examine the contribution the group's corporate responsibility activities make towards protecting and enhancing this

– Monitor and review compliance with the board's CR policy and scrutinise the effectiveness of the delivery of the CR policy requirements

– Develop and recommend to the board CR targets and key performance indicators and receive and review reports on progress towards the achievement of such targets and indicators

– Review all approved specific giving where the aggregate financial contribution exceeds £100,000 over the period of the proposed funding and to review all community giving expenditure annually

– Review the profile of the charitable donations directed by the United Utilities Trust Fund

What has been on the committee's agenda during the year

In carrying out its duties, in the past 12 months the CRC has paid particular attention to:

– governance – the committee and board agreed to amend its terms of reference to acknowledge how the CRC has increasingly focused on the close relationship between the CR agenda and reputation, a theme also noted in the committee's annual evaluation;

– trust and reputation – how the company addressed the challenges of trust and transparency, especially after a year in which major events took place, notably the water quality incident and the winter floods. The committee conducted a deep dive into evidence gathered on customer views and also reviewed the key reputational risks facing the company;

– communicating responsible business – how strong external communication of the company's corporate responsibility achievements will be a central part of building positive relationships with its broad range of stakeholders; and

– measuring and reporting CR performance – the CRC reviewed the company's CR scorecard for 2014/15, noting strengthening performance on the majority of measures. The continued use of such metrics to demonstrate tangible delivery of responsible business performance was agreed and a scorecard for 2015 to 2020 was approved.

Specific topics included:

– resilience to climate change – in light of the December 2015 floods, the CRC examined the company's approach. The committee encouraged close scrutiny of the opportunities and risks for the company and the wider sector, consequent upon government and regulators' reviews of resilience;

– carbon strategy and targets – the committee approved a new more ambitious carbon target, recognising that, as for all companies, the outcome could be affected by government decisions on the UK energy mix and energy-related taxation and incentives;

– diversity and inclusion – progress made by the company to improve the diversity of its workforce was examined, in particular, how the focus on women has had a positive impact. The CRC noted limited progress with black and minority ethnic employees, a challenge given the company's main areas of activity are not located in ethnically diverse locations. The appointment of a senior director as diversity champion was acknowledged, as was the company's attainment of a Bronze Award in Race for Opportunity;

– priority customers – the CRC noted with approval a comprehensive new policy for engagement with vulnerable customers, launched as a new service proposition in May 2016 called 'Priority Services'. The committee supported the provision of a holistic service to customers with needs categorised as: physical, mental health, financial, language and life events; and

– community strategy and spend – the committee discussed an updated framework for community investment and supported the intention that it would help prioritise investment objectives, emphasising the need for a flexible approach to accommodate changing circumstances.

Looking to the next year, the CRC will:

– review progress in delivering responsible business targets set out to 2020;

– continue its focus on the interaction between CR, communications and reputation, including a regular look at key reputational risks and the company's approach to stakeholder engagement;

– review progress in delivering a number of CR strategies including:
  – natural environment strategy and the company's approach to natural capital;
  – resilience and climate change;
  – sustainable supply chain;
  – waste and resource efficiency;
  – debt and affordability;
  – priority customers;
  – talent and young people;
  – diversity and inclusion; and
  – the company's approach to community investment.

– consider other matters such as integrated reporting in the 2016/17 annual report and the nature of environmental and social training for board members.

Corporate governance report
Annual statement from the remuneration committee chair

Sara Weller, chair of the remuneration committee

The committee is fully committed to continuing to align executive pay with the company's strategy of delivering value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

Quick facts

The Code requires that 'the board should establish a remuneration committee of at least three independent non-executive directors'

The role of the committee is to set remuneration terms for all executive directors, other senior executives and the Chairman

By invitation of the committee, meetings are also attended by the Chairman, the CEO, the company secretary, the business services director, the head of reward and the external advisor to the committee

Quick links

Terms of reference – **corporate.unitedutilities.com/corporate-governance**

Directors' remuneration policy – **annualreport2014.unitedutilities.com/site-essentials/downloads/annual-report-2014**

Index

Dear Shareholder

I am pleased to introduce the directors' remuneration report for the year ended 31 March 2016, which includes my statement, a summary of the directors' remuneration policy which took effect from the date of our 2014 AGM, and the annual report on remuneration for the year ended 31 March 2016.

Alignment to strategy

The committee is fully committed to continuing to align executive pay with the company's strategy of delivering value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner. We seek to achieve this by strongly linking pay with performance, both at an individual and company level, and by encouraging a significant investment in company shares. We also recognise that a long-term focus is essential to creating value and therefore require executives to defer a significant portion of their incentives.

Implementation of policy in 2015/16

Annual bonus

In 2014/15 the committee reviewed the annual bonus measures to ensure that they fully incentivise delivery of our business strategy and annual plan, and reflect the importance and challenge of regulatory commitments for the period 2015–20. These bonus measures apply not only to the executive directors, but also to managers and employees through the company, to ensure alignment to the business plan at all levels.

As set out in detail in the annual report on remuneration, in this first year of the new regulatory period underlying financial and operational performance was good with underlying operating profit of £604 million, effective delivery of our accelerated capital programme targets, positive performance against Ofwat's outcome delivery incentives (ODIs) and retention of 'World Class' status in the Dow Jones Sustainability index.

Bonuses were lower than in 2014/15 reflecting the significant operational challenges which occurred during the year, including the prolonged water quality incident in Lancashire. Levels of customer service as measured by Ofwat's service incentive mechanism (SIM) fell during this incident and there was a net penalty in respect of the ODIs for water supply. Reflecting the impact on profit for shareholders and the inconvenience to customers caused by the water quality incident, the committee also used its discretion to reduce the underlying operating profit figure used for assessing bonus outcome for the executive directors by deducting the £25 million costs related to the incident.

Overall, the company's performance resulted in annual bonus out-turns for the executive directors of around 54 per cent of maximum (lower than the 2014/15 outcome of 77 per cent of maximum) and a company-wide bonus pool totalling £13 million (down from £15 million in the prior year).

Long-term incentives

The Long Term Plan awards which were granted in 2013, and whose performance is measured over the three years to 31 March 2016, are expected to vest at 34 per cent. Despite strong total shareholder return over the period of around 50 per cent, the sustainable dividend measure achieved only threshold performance (following dividend growth for the 2015/16 financial year of RPI and the achievement of an underlying dividend cover underpin) and the customer service excellence measure is expected to out-turn below threshold level (set at median position versus comparator water companies). The awards for executive directors will vest following an additional two-year holding period.

During the year both executive directors reached their respective fifth anniversaries of joining the company. Matching shares, which had been awarded under one-off Matching Share Incentive Schemes as part of their terms of appointment, vested in full. Shareholders benefitted from a total shareholder return of around 100 per cent over these five-year periods.

Shareholding requirements

To provide further alignment with shareholder interests, the board agreed in May 2015 to increase the shareholding guideline for executive directors from 100 per cent to 200 per cent of base salary. Both executive directors have a shareholding in excess of this level.

Agenda for 2016/17

During 2016/17 the committee will be reviewing the directors' remuneration policy ahead of seeking approval from shareholders for a revised policy at the 2017 AGM. We will be seeking feedback from shareholders as part of this review.

I hope we will receive your support for the resolution relating to remuneration at the 2016 AGM.

Sara Weller
Chair of the remuneration committee

At a glance summary: Executive directors' remuneration

Key element	Implementation of policy
Base salary	– Salary increase of 2.0 per cent from 1 September 2015 in line with the wider workforce
Benefits and pension	– Market competitive benefits package – Cash pension allowance of 22 per cent of base salary
Annual bonus	– Maximum opportunity of 130 per cent of base salary – Annual bonus measures changed for 2015/16 to align with new regulatory period 2015–20 – 2015/16 annual bonus outcome of around 54 per cent of maximum – 50 per cent of 2015/16 annual bonus deferred in shares for three years – Malus and clawback provisions apply
Long Term Plan	– Maximum opportunity of 130 per cent of base salary – Estimated long-term incentive vesting of 34 per cent for the performance period 1 April 2013 to 31 March 2016, supported by a total shareholder return of around 50 per cent over the same period. These awards will vest after an additional two-year holding period – Malus provisions apply
One-off recruitment awards	– Both executive directors received shares in relation to the vesting of their one-off Matched Share Investment Schemes which were awarded to them as part of their recruitment terms
Shareholding guidelines	– Personal shareholdings remain significantly above the 200 per cent of salary minimum guideline

Corporate governance report
Aligning remuneration to business strategy

Our remuneration policy has been designed in order to promote the long-term success of the company.

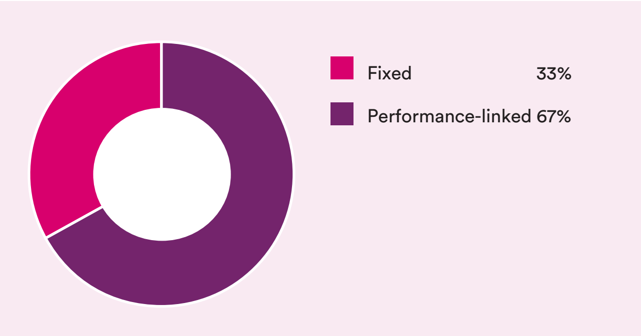
The following table provides a summary of how our incentive framework aligns with our business strategy and the results that it delivers. Many of the performance measures are key performance indicators (KPIs) for the regulatory period 2015–20 (see pages 28 and 29).

	Alignment to strategy	Link to strategic objectives	A long-term approach to creating value
Annual bonus			
Underlying operating profit	Key measure of shareholder value.	Lowest sustainable cost	✓
Customer service in year – Service incentive mechanism – qualitative – Service incentive mechanism – quantitative	Delivering the best service to customers is a strategic objective. Ofwat can apply financial incentives or penalties depending on our customer service performance.	Best service to customers	✓
Maintaining and enhancing services for customers – Wholesale outcome delivery incentive (ODI) composite – Time, cost and quality of the capital programme (TCQi)	Delivering the best service to customers is a strategic objective. There is a direct financial impact on the company of Ofwat incentives and penalties for delivery/non-delivery of customer promises. Keeping tight control of our capital programmes ensures we can provide a reliable service to our customers at the lowest sustainable cost.	Best service to customers; Lowest sustainable cost; Responsible manner	✓
Corporate responsibility – Dow Jones Sustainability Index	Ensures that we manage our business in a responsible manner.	Responsible manner	✓
Personal		Best service to customers; Lowest sustainable cost; Responsible manner	✓
Compulsory deferral of bonus	Deferral of part of bonus into shares aligns the interests of executive directors and shareholders.	Responsible manner	✓
Long Term Plan (LTP)			
Relative total shareholder return (TSR)	Direct measure of delivery of shareholder returns, rewarding management for the outperformance of a comparator group of companies.		✓
Sustainable dividends	Direct measure of return to shareholders through dividend payments, whilst focusing on the creation of strong earnings that ensure the sustainability of dividends.	Lowest sustainable cost; Responsible manner	✓
Customer service excellence	This is fundamental to delivering our vision of becoming the best UK water and wastewater company, providing great service to our customers. This measure has a direct financial impact on the company as Ofwat can apply financial incentives or penalties depending on our customer service performance.	Best service to customers; Responsible manner	✓
Additional two-year holding period	Ensures continued alignment with shareholder interests and provides an additional period over which malus can be applied.	Responsible manner	✓
Shareholding guidelines	It is important that a significant investment is made by each executive director in the shares of the company to provide alignment with shareholder interests.		✓

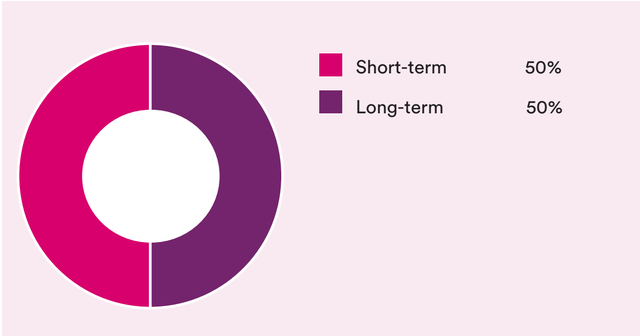
Key: ■ Best service to customers ■ Lowest sustainable cost ■ Responsible manner

A significant proportion of executive directors' pay is performance-linked, long-term and remains 'at risk' (i.e. subject to clawback and malus provisions for a period over which the committee can recover sums paid or withhold vesting):

Fixed vs performance-linked (%)[1]

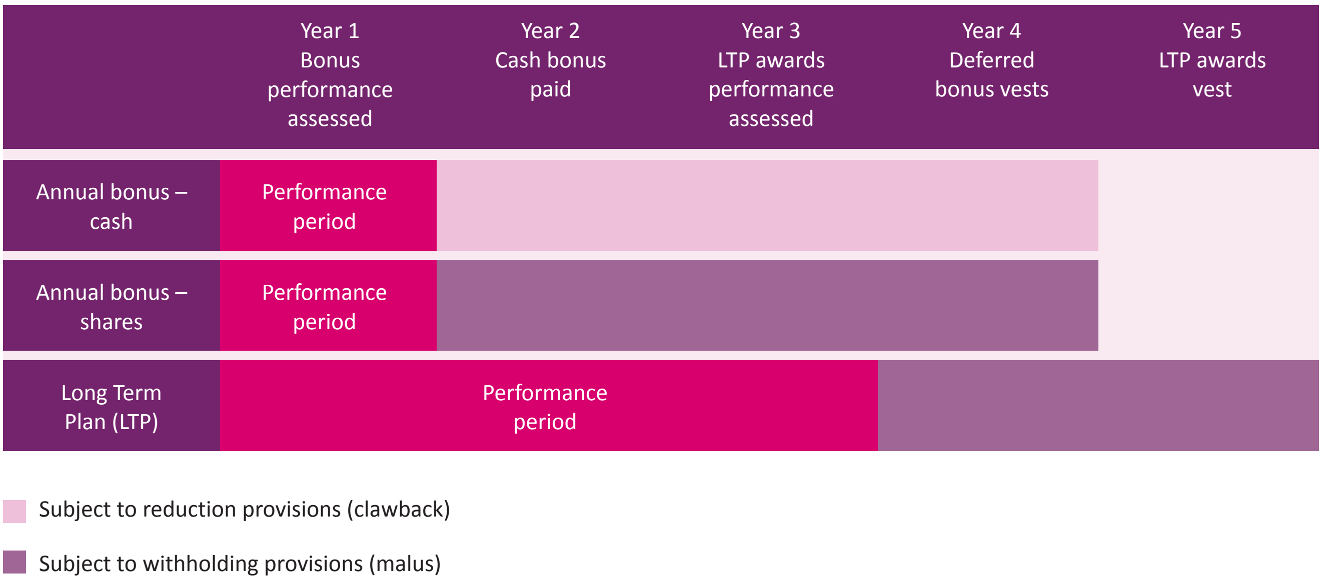


Short-term vs long term (%)[1]



(1) Based on maximum payout scenario for executive directors. Fixed consists of base salary, benefits and pension. Performance-linked consists of the Long Term Plan (LTP) and annual bonus. Short-term consists of fixed remuneration plus annual bonus paid as cash. Long-term consists of LTP plus annual bonus deferred into shares under the Deferred Bonus Plan (DBP).

Pay at risk



Further details on what triggers clawback or malus are set out on pages 87 and 88.

Corporate governance report
Directors' remuneration policy (abridged)

This part of the directors' remuneration report sets out an abridged version of the remuneration policy which was approved by shareholders at the AGM on 25 July 2014. The policy took formal effect from the date of approval and is intended to apply until the 2017 AGM.

In the interests of clarity, the report includes some minor annotations to additionally show, where appropriate, how the policy will be implemented in 2016/17. A full version of the shareholder approved policy can be found in the Annual Report and Financial Statements for the year ended 31 March 2014 **annualreport2014.unitedutilities.com/site-essentials/downloads/annual-report-2014**

Overview of remuneration policy

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

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

Policy table for directors

Base salary

Read more about **Base salary** on page **91**

Purpose and link to strategy: To attract and retain executives of the experience and quality required to deliver the company's strategy.

Operation	Maximum opportunity
Reviewed annually, effective 1 September. Significant increases in salary should only take place infrequently, for example where there has been a material increase in: – the size of the individual's role; – the size of the company (through mergers and acquisitions); or – the pay market for directly comparable companies (for example, companies of a similar size and complexity). On recruitment or promotion to executive director, the committee will take into account previous remuneration and pay levels for comparable companies when setting salary levels. This may lead to salary being set at a lower or higher level than for the previous incumbent.	Current salary levels are shown in the annual report on remuneration. Executive directors will normally receive a salary increase broadly in line with the increase awarded to the general workforce, unless one or more of the conditions outlined under 'operation' is met. Where the committee has set the salary of a new hire at a discount to the market level initially, a series of planned increases can be implemented over the following few years to bring the salary to the appropriate market position, subject to individual performance. **Performance measures** None.

Benefits

Read more about **Benefits** on page **91**

Purpose and link to strategy: To provide market competitive benefits to help recruit and retain high calibre executives.

Operation	Maximum opportunity
Provision of benefits such as: – health benefits; – car or car allowance; – relocation assistance; – life assurance; – group income protection; – all employee share schemes (e.g. opportunity to join the ShareBuy scheme); – travel; and – communication costs. Additional benefits might be provided from time to time if the committee decides payment of such benefits is appropriate and in line with emerging market practice.	As it is not possible to calculate in advance the cost of all benefits, a maximum is not pre-determined. **Performance measures** None.

Policy table for directors continued

Pension Read more about **Pension** on page **96**

Purpose and link to strategy: To provide a broadly mid-market level of retirement benefits.

Operation	Maximum opportunity
Executive directors are offered the choice of: – a company contribution into a defined contribution pension scheme; or – a cash allowance in lieu of pension; or – a combination of a company contribution into a defined contribution pension scheme and a cash allowance. External hires will not be eligible to join a defined benefit pension scheme. Internal promotees who are active members of a United Utilities defined benefit scheme will be offered the choice of staying in that scheme or of choosing one of the above options.[1]	– 25 per cent of salary into a defined contribution scheme; or – a cash allowance of 22 per cent of base salary; or – a combination of both such that the cost to the company is broadly the same. Under the defined benefit schemes, a maximum future accrual of 1/80th pension plus 3/80ths lump sum of final pensionable salary for each year of service.[1] **Performance measures** None.

Annual bonus Read more about **Annual bonus** on pages **92 and 93**

Purpose and link to strategy: To incentivise performance against personal objectives and selected financial and operational KPIs which are directly linked to business strategy. Deferral of part of bonus into shares aligns the interests of executive directors and shareholders.

Operation	Maximum opportunity
50 per cent paid as cash. 50 per cent deferred into company shares under the Deferred Bonus Plan (DBP) for three years. DBP shares accrue dividend equivalents. Not pensionable. Bonuses are subject to clawback or malus in the event of a material overstatement in the financial statements of the company because of fraud or error. Deferred shares under the DBP are subject to malus in such negative circumstances as the committee considers is appropriate. For example: material misstatement of audited financial results, serious failure of risk management or serious reputational damage.	Maximum 130 per cent of salary bonus potential, for the achievement of stretching performance objectives. **Performance measures** Payments predominantly based on financial and operational performance, with a minority based on achievement of personal objectives. Targets set by reference to the company's financial and operating plans. Target bonus of 50 per cent of maximum bonus potential and bonus of 25 per cent of maximum for threshold performance.

(1) In 2010 the company made a number of changes to defined benefit pension provision including a restriction on salary increases which count for pension purposes. Since that time salary increases above inflation (RPI), including those relating to any promotions, are no longer pensionable.

Corporate governance report
Directors' remuneration policy (abridged)

Policy table for directors continued

Long Term Plan (LTP) Read more about **Long Term Plan** on pages **94 to 96**

Purpose and link to strategy: To incentivise long-term value creation and alignment with longer-term returns to shareholders.

Operation	Maximum opportunity
Awards under the Long Term Plan are rights to receive company shares, subject to certain performance conditions. Each award is measured over a three-year performance period starting at the beginning of the financial year in which awards are granted. An additional two-year holding period applies after the end of the three-year performance period. Vested shares accrue dividend equivalents. Shares under the LTP are subject to malus in such negative circumstances as the committee considers are appropriate. For example: material misstatement of audited financial results, serious failure of risk management or serious reputational damage.	130 per cent of salary per annum. In exceptional circumstances the committee retains the discretion to grant awards up to plan limits of 200 per cent of salary. **Performance measures** One-third of awards vest based on relative total shareholder return (TSR), one-third based on customer service excellence and one-third based on a sustainable dividends performance condition. Any vesting is also subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance. 100 per cent of awards vest for stretch performance, 25 per cent of an award vests for threshold performance and no awards vest for below threshold performance.

Non-executive directors' fees and benefits Read more about **Non-executive directors' fees and benefits** on page **99**

Purpose and link to strategy: To attract non-executive directors with a broad range of experience and skills to oversee the development and implementation of our strategy.

Operation	Maximum opportunity
The remuneration policy for the non-executive directors (with the exception of the Chairman) is set by a separate committee of the board. The policy for the Chairman is determined by the remuneration committee (of which the Chairman is not a member). Fees are reviewed annually taking into account the levels of fees paid by companies of a similar size and complexity. Any changes are effective from 1 September. Additional fees are paid to the chairs of certain board sub-committees and for the senior independent non-executive director. No eligibility for bonuses, long-term incentive plans, pension schemes, healthcare arrangements or employee share schemes. The company repays any reasonable expenses that a non-executive director incurs in carrying out their duties as a director. In addition, travel, hospitality-related and other modest benefits will be payable on occasion.	Current fee levels are shown in the annual report on remuneration. The value of benefits may vary from year to year according to the cost to the company. **Performance measures** Non-executive directors are not eligible to participate in any performance-related arrangements.

Notes to the policy table

Selection of performance measures and targets

Performance measures for the annual bonus are selected annually to align with the company's key strategic goals for the year and reflect financial, operational and personal objectives. 'Target' performance is typically set in line with the business plan for the year, following rigorous debate and approval of the plan by the board. Threshold to stretch targets are then set based on a sliding scale on the basis of relevant commercial factors. Only modest rewards are available for delivering threshold performance levels, with rewards at stretch requiring substantial outperformance of the business plan. Details of the measures used for the annual bonus are given in the annual report on remuneration.

LTP targets are set taking into account a number of factors, including reference to market practice, the company business plan and analysts' forecasts where relevant. The LTP will only vest in full if stretching business performance is achieved.

Annual bonus and long-term incentives – flexibility, discretion and judgement

The committee will operate the company's incentive plans according to their respective rules and consistent with normal market practice, the Listing Rules and HMRC rules where relevant, including flexibility in a number of regards.

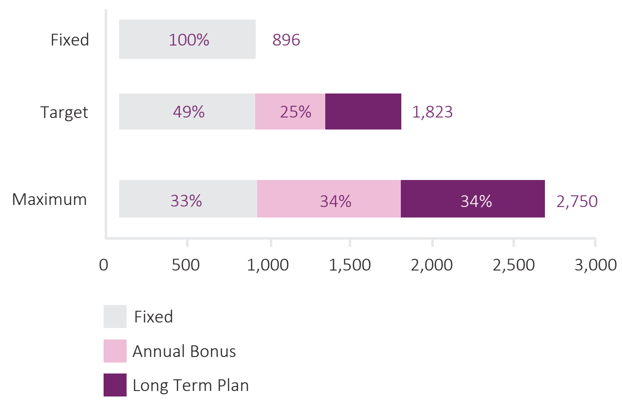
Any discretion exercised (and the rationale) will be disclosed in the annual remuneration report.

Scenarios for total remuneration

The charts below show the payout under the remuneration policy for each executive director under three different scenarios. Please note that the charts have been updated from those in the policy approved at the AGM on 25 July 2014 to reflect updated fixed pay figures.

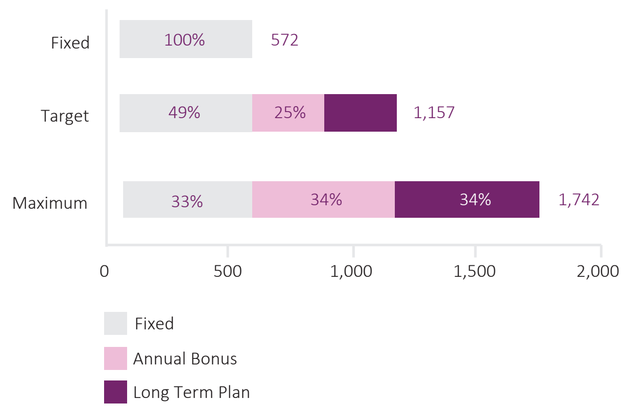
Steve Mogford CEO

£'000s



Russ Houlden CFO

£'000s



Notes on the scenario methodology:

- Fixed pay is latest known salary plus cash allowance in lieu of pension of 22 per cent of salary and the value of benefits as shown in the single total figure of remuneration table for 2015/16.
- Target performance is the level of performance required for the bonus and Long Term Plan to pay out at 50 per cent of maximum.
- Maximum performance would result in 100 per cent vesting of the bonus and Long Term Plan.
- Annual bonus includes amounts compulsorily deferred into shares.
- Long Term Plan is measured at face value i.e. no assumption for dividends or changes in share price.
- Amounts relating to all-employee share schemes have, for simplicity, been excluded from the charts.

Corporate governance report
Directors' remuneration policy (abridged)

Service contracts and letters of appointment

Executive directors' service contracts are subject to up to one year's notice period when terminated by the company and at least six months' notice when terminated by the director. A company notice period longer than one year may be provided if necessary for recruitment, but reducing to a rolling one-year period after the initial period has expired.

The policy on payments for loss of office is set out in the next section.

The Chairman and other non-executive directors have letters of appointment rather than service contracts. Their appointments may be terminated without compensation at any time. All non-executive directors are subject to re-election at the AGM.

Copies of executive directors' service contracts and non-executive directors' letters of appointment are available for inspection at the company's registered office during normal hours of business and will be available at the company's AGM. Copies of non-executive directors' letters of appointment can also be viewed on the company's website.

Shareholding guidelines

The committee believes that it is important for a significant investment to be made by each executive director in the shares of the company to provide alignment with shareholder interests. Executive directors are encouraged to build up and retain a targeted shareholding of at least 100 per cent of base salary, normally within five years of appointment. There is an expectation that executive directors will continue to build a shareholding throughout their period of employment with the company, after the target shareholding is reached.

Implementation 2015/16: Minimum shareholding guideline has increased to 200 per cent of salary.

Approach to recruitment remuneration

The remuneration package for a new executive director would be set in accordance with the terms of the company's approved remuneration policy in force at the time of appointment.

Buy-out awards

In addition, the committee may offer additional cash and/or share-based elements (on a one-time basis or ongoing) when it considers these to be in the best interests of the company (and therefore shareholders). Any such payments would be limited to a reasonable estimate of value of remuneration lost when leaving the former employer and would reflect the delivery mechanism (i.e. cash and/or share-based), time horizons and whether performance requirements are attached to that remuneration. Shareholders will be informed of any such payments at the time of appointment.

Maximum level of variable pay

The maximum initial level of long-term incentives which may be awarded to a new executive director will be limited to the maximum Long Term Plan limit of 200 per cent of salary. Therefore, the maximum initial level of overall variable pay that may be offered will be 330 per cent of salary (i.e. 130 per cent annual bonus plus 200 per cent Long Term Plan). These limits are in addition to the value of any buy-out arrangements which are governed by the policy above.

In the case of an internal appointment, any variable pay element awarded in respect of the prior role would be allowed to pay out according to its terms, adjusted as relevant to take into account the appointment. In addition, any other previously awarded entitlements would continue and be disclosed in the next annual report on remuneration.

Base salary and relocation expenses

The committee has the flexibility to set the salary of a new appointment at a discount to the market level initially, with a series of planned increases implemented over the following few years to bring the salary to the appropriate market position, subject to individual performance in the role.

For external and internal appointments, the committee may agree that the company will meet certain relocation expenses as appropriate.

Appointment of non-executive directors

For the appointment of a new Chairman or non-executive director, the fee arrangement would be set in accordance with the approved remuneration policy in force at that time. Non-executive directors' fees are set by a separate committee of the board; the Chairman's fees are set by the remuneration committee.

Payment for loss of office

The circumstances of the termination (taking into account the individual's performance) and an individual's duty and opportunity to mitigate losses are taken into account in every case. Our policy is to stop or reduce compensatory payments to former executive directors to the extent that they receive remuneration from other employment during the compensation period. A robust line on reducing compensation is applied and payments to departing employees may be phased in order to mitigate loss. A full version of the policy can be found in the Annual Report and Financial Statements for the year ended 31 March 2014 **annualreport2014.unitedutilities.com/site-essentials/downloads/annual-report-2014**

Corporate governance report
Annual report on remuneration

Executive directors' remuneration for the year ended 31 March 2016

Single total figure of remuneration for executive directors (audited information)

	Base salary £'000		Benefits £'000		Annual bonus £'000		Long-term incentives £'000		Pension £'000		Other[2] £'000		Total £'000	
Year ended 31 March	**2016**	2015	**2016**	2015	**2016**	2015	**2016**[1]	2015	**2016**	2015	**2016**	2015	**2016**	2015
Steve Mogford	**707**	692	**26**	26	**501**	696	**1,440**	1,287	**156**	152	**0**	31	**2,830**	2,884
Russ Houlden	**446**	437	**23**	23	**313**	440	**688**	804	**98**	96	**0**	23	**1,568**	1,823

(1) The long-term incentive amount is in respect of the Long Term Plan award which was granted in July 2013 (and which will vest based on performance over the three-year period 1 April 2013 to 31 March 2016) and the executive directors' one-off Matched Share Investment Scheme awards which were granted as part of their terms of appointment and vested during the year. The Long Term Plan amount is estimated as the vesting percentage for the one-third relating to customer service excellence will not be known until later in 2016 and the award will not vest until the end of an additional two-year holding period. The table below shows the breakdown of the amount in the single total figure of remuneration table. See pages 94 and 95 for further detail.

	Executive director	
Scheme	**Steve Mogford**	**Russ Houlden**
2013 Long Term Plan	412	261
Matched Share Investment Scheme	1,028	427
Total (shown in the single total figure of remuneration table)	1,440	688

(2) The figures in this column represent the value of matching shares under the ShareBuy scheme which vested in the year, valued using the closing share price on the day they vested (the company offers a one-for-five match on partnership shares bought by employees under ShareBuy which cease to become forfeitable one year after they are awarded). For the year ending 31 March 2015, the figures also include the value of a discretionary cash payment which was made in lieu of dividends foregone on vested long-term incentives, due to the extended restrictions which were in place on buying and selling shares.

Base salary

Executive director salaries were increased by 2.0 per cent with effect from 1 September 2015, in line with the headline increase applied across the wider workforce. The committee felt that the increase was supported by satisfactory individual and business performance.

	Base salary £'000	
Executive director	**1 Sept 2015**	1 Sept 2014
Steve Mogford	**713.0**	699.0
Russ Houlden	**450.0**	441.3

Benefits

For executive directors, benefits include a car allowance of £14,000; health, life and income protection insurance; travel costs; and communication costs.

No changes are expected to benefits during the year commencing 1 April 2016 (see page 86 in the policy report).

Corporate governance report
Annual report on remuneration

Annual bonus

Annual bonus in respect of financial year ended 31 March 2016 (audited information)

Bonuses are earned by reference to the financial year and paid in June following the end of the financial year. Fifty per cent of any bonus is deferred into shares for three years under the Deferred Bonus Plan.

The performance measures, targets and outcomes in respect of the executive directors' annual bonus for the year ended 31 March 2016 are set out below. The table on page 84 summarises how these performance measures are linked to our business strategy.

Measure	Threshold (25% vesting)	Achieved	Stretch (100% vesting)	Payout as a % of maximum	Steve Mogford weighting (% of award) / **Outcome**	Russ Houlden weighting (% of award) / **Outcome**
Underlying operating profit[1]						
	£737.3m	£747.3m	£787.3m	35%	30.0%	30.0%
					10.5%	**10.5%**
Customer service in year						
Service incentive mechanism – qualitative	4.26	4.27	4.40	29%	12.0%	12.0%
					3.4%	**3.4%**
Service incentive mechanism – quantitative	99	95	89	45%	4.0%	4.0%
					1.8%	**1.8%**
Maintaining and enhancing services for customers						
Wholesale outcome delivery incentive composite	(£15.6m)	£2.5m	£15.5m	58%	20.0%	20.0%
					11.6%	**11.6%**
Time, cost and quality of capital programme (TCQi)[2]	73%	89.9%	98%	71%	20.0%	20.0%
					14.2%	**14.2%**
Corporate responsibility						
Dow Jones Sustainability Index rating		100%	World Class	100%	4.0%	4.0%
					4.0%	**4.0%**
Personal objectives						
Steve Mogford – The committee's overall assessment of each executive director's performance against their own challenging personal objectives		90%		90%	10.0%	
					9.0%	
Russ Houlden		85%		85%		10.0%
						8.5%
Total:						
Actual award (% of maximum)					**54.5%**	**54.0%**
Maximum award (% of salary)					130%	130%
Actual award (% of salary) (£'000 – shown in single figure table)[3]					**70.8% £501k**	**70.1% £313k**

(1) Underlying operating profit is subject to a number of adjustments, principally in regard to infrastructure renewals expenditure. Reflecting the impact on profit for shareholders and the inconvenience to customers caused by the water quality incident in Lancashire, the committee used its discretion to reduce the underlying operating profit figure used for assessing bonus outcome for the executive directors by deducting the £25m costs related to the incident. The figure shown in the table above is the underlying operating profit after the deduction of these costs.

(2) TCQi is an internal measure which measures the extent to which we deliver our capital projects on time, to budget and to the required standard. It is expressed as a percentage, with a higher percentage representing better performance.

(3) Under the Deferred Bonus Plan, 50 per cent of the annual bonus will be deferred in shares for three years.

Pictured right: Haweswater reservoir, Cumbria

Annual bonus in respect of financial year commencing 1 April 2016

The maximum bonus opportunity for 2016/17 will remain unchanged at 130 per cent of base salary.

The performance measures and weightings for the executive directors' annual bonus for the year commencing 1 April 2016 will be unchanged from those for the year commencing 1 April 2015. The targets for the TCQi and corporate responsibility measure are shown below. Please note that the other targets are considered commercially sensitive, and consequently these will only be disclosed after the end of the 2016/17 financial year in the 2016/17 annual report on remuneration.

	Targets		
Measure	**Threshold (25% vesting)**	**Stretch (100% vesting)**	**Weighting (% of award)**
Maintaining and enhancing services for customers			
Time, cost and quality of capital programme (TCQi)[1]	82.0%	98.0%	20.0%
Corporate responsibility			
Dow Jones Sustainability Index rating		World Class	4.0%

(1) TCQi is an internal measure which measures the extent to which we deliver our capital projects on time, to budget and to the required standard. It is expressed as a percentage, with a higher percentage representing better performance.

Corporate governance report
Annual report on remuneration

Long-term incentives

Performance for vested awards

2013 Long Term Plan (LTP) awards with a performance period ending 31 March 2016 (audited information)

The 2013 LTP awards were granted in July 2013 and performance was measured over the three-year period 1 April 2013 to 31 March 2016. Executive directors' awards will normally vest in April 2018, following an additional two-year holding period. The unvested shares will remain subject to malus provisions over this two-year holding period.

Note that the final outcome for the customer service excellence measure (which forms 33 per cent of the award) will not be known until Ofwat publishes the combined service incentive mechanism scores for the company and its comparator water companies (expected to be published in late summer 2016). The value of the 2013 LTP awards in the single total figure of remuneration table is therefore estimated and will be restated in next year's report once the final outcome is known.

The table below shows how the long-term incentive amount in respect of the 2013 LTP was calculated:

Measure		Achieved: Threshold (25% vesting)	Achieved: Intermediate (80% vesting)	Achieved: Stretch (100% vesting)	Payout as a % of maximum	Steve Mogford weighting (% of award) Outcome	Russ Houlden weighting (% of award) Outcome
Relative total shareholder return (TSR)							
TSR versus median TSR of FTSE 100 companies (excluding financial services, oil & gas, and mining companies)[1]		Median TSR		Median TSR × 1.15	75.9%	33.3%	33.3%
		Median TSR x 1.10				**25.3%**	**25.3%**
Measured over the three year performance period		Company TSR of 46.7% was between the threshold TSR of 33.1% and stretch TSR of 53.1%					
Sustainable dividends							
Dividend growth in year ending 31 March 2016		RPI+0%		RPI+2%	25.0%	33.3%	33.3%
		RPI +0% [2]				**8.3%**	**8.3%**
Underpin 1:	✓ Met	At least RPI+2% growth in each of the years ending 31 March 2014 and 31 March 2015					
Underpin 2:	✓ Met	Average underlying dividend cover of at least 1.1 over the three year performance period					
Customer service excellence							
Ranking for the year ended 31 March 2016 versus 18 other water companies using Ofwat's service incentive mechanism (SIM) combined score		Median rank	Upper quartile rank	Upper decile rank	0.0%	33.3%	33.3%
		Estimate: Below median				**0.0%**	**0.0%**
		Note that this is an estimate as the final outcome will not be known until the combined SIM scores are published later in 2016.					
Overall underpin							
Overall vesting is subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance		✓ Assumed met. Note that the committee will make a final assessment of the company's performance once the combined SIM scores are known.					
Estimated vesting (% of award)						**33.6%**	**33.6%**
Number of shares granted						120,746	76,203
Number of dividend equivalent shares						12,402	7,826
Number of shares before performance conditions applied						133,148	84,029
Estimated number of shares after performance conditions applied						44,737	28,233
Three-month average share price at end of performance period[3]						£9.23	£9.23
Estimated value at end of performance period (£'000 – shown in single figure table)						**£412**	**£261**

(1) For the purposes 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.
(2) Subject to approval of the final dividend by shareholders at the 2016 AGM.
(3) Average share price over the three-month period 1 January 2016 to 31 March 2016.

Matched Share Investment Scheme (MSIS) awards which vested in the year ending 31 March 2016 (audited information)

When they joined the company in 2010/11, both executive directors received a one-off MSIS award as part of their terms of appointment. They acquired shares in the company at their own expense ('investment shares') which would be matched under the MSIS on a 1:1 basis ('matching shares') provided that they remained employees within the group until the fifth anniversary of their date of joining the company and did not sell their investment shares. Full details of these awards were disclosed in the 2010/11 annual report.

During the year the executive directors reached their fifth anniversaries of joining and the matching shares vested in full. Since they bought their investment shares, shareholders have benefitted from a total shareholder return of around 100 per cent.

The table below shows how the long-term incentive amount in respect of the MSIS was calculated:

	Steve Mogford	Russ Houlden
Date joined the company	05.01.11	01.10.10
Date of grant	27.05.11	16.12.10
Vesting date	05.01.16	01.10.15
Value of investment shares bought (£'000)	£500	£210
Number of matching shares granted	86,742	36,710
Number of dividend equivalent shares	22,522	9,528
Number of matching shares vested	109,264	46,238
Closing share price on date of vesting	£9.41	£9.25
Value of matching shares on vesting (£'000 - shown in single figure table)	£1,028	£427

Performance targets for awards granted in the year

2015 LTP awards with a performance period ending 31 March 2018 (audited information)

Following the announcement by the board in January 2015 of our dividend policy for the regulatory period 2015–20, the sustainable dividend measure in the LTP switched focus from dividend growth as the differentiator of performance with dividend cover as an underpin, to dividend cover being the differentiator with the delivery of our dividend policy as an underpin.

Details about the 2015 LTP performance measures and targets are shown in the following table. Performance is measured over the three-year period 1 April 2015 to 31 March 2018. The table on page 84 summarises how these performance measures are linked to our business strategy.

	Targets			
Measure	Threshold (25% vesting)	Intermediate	Stretch (100% vesting)	Weighting
Relative total shareholder return (TSR)				
TSR versus median TSR of FTSE 100 companies (excluding financial services, oil and gas, and mining companies).(1) Measured over the three year performance period	Median TSR	–	Median TSR × 1.15	33.3%
Sustainable dividends				
Average underlying dividend cover over the three-year performance period	The targets are considered commercially sensitive and so are not disclosed in this report. However, actual targets, performance achieved and awards made will be published retrospectively so that shareholders can fully understand the basis for any payouts			33.3%
Underpin:	Dividend growth of at least RPI in each of the years ending 31 March 2016, 31 March 2017 and 31 March 2018			
Customer service excellence				
Ranking for the year ended 31 March 2018 versus 18 other water companies using Ofwat's Service Incentive Mechanism (SIM) combined score	Median rank	Upper quartile rank (80% vesting)	Upper decile rank	33.3%
Overall underpin				
Overall vesting is subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance				

(1) For the purposes 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.

Straight-line vesting applies between the threshold, intermediate and stretch targets, with nil vesting below threshold performance. The committee will have the flexibility to make appropriate adjustments to the performance targets in exceptional circumstances, to ensure that the award achieves its original purpose.

Corporate governance report
Annual report on remuneration

Performance targets for future awards

2016 LTP awards with a performance period ending 31 March 2019

The performance targets for the 2016 Long Term Plan (LTP) are expected to be as for the 2015 awards outlined above, with the exception of the targets for the sustainable dividend performance measure.

Pensions

The executive directors receive a cash allowance of 22 per cent of base salary in lieu of pension. No changes are expected to pensions during the year commencing 1 April 2016.

External 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 would be of benefit to the company. Any external appointments are subject to board approval (which would not be given if the proposed appointment was with a competing company, would lead to a material conflict of interest or could have a detrimental effect on a director's performance).

Steve Mogford was a non-executive director of Carillion PLC until 31 December 2015 for which he received an annual fee of £60,000. Russ Houlden is an independent member of the supervisory board, and audit committee chairman, of Orange Polska SA for which he receives and retains fees estimated annually at around £68,000.

Executive directors' interests in shares

Executive directors' shareholding (audited information)

To provide further alignment with shareholder interests, in May 2015 the board agreed to increase the shareholding guidelines for executive directors from 100 per cent to 200 per cent of base salary. Executive directors are normally expected to reach this shareholding within five years of appointment. There is also an expectation that they will continue to build a shareholding throughout their period of employment with the company after the guideline is reached.

Details of beneficial interests in the company's ordinary shares as at 31 March 2016 held by each of the executive directors and their connected persons are set out in the table below along with progress against the target shareholding guideline level. The table shows that both Steve Mogford and Russ Houlden have exceeded the target shareholding.

		Shares counting towards shareholding guidelines at 31 March 2016					
Director	Number of shares required to meet shareholding guideline(1)	Number of shares owned outright (including connected persons)	Unvested shares not subject to performance conditions(2)	Total shares counting towards shareholding guidelines(3)	Shareholding as % of base salary at 31 March 2016(1)	Shareholding guideline met at 31 March 2016	Unvested shares subject to performance conditions(4)
Steve Mogford(5)	154,530	297,164	135,813	369,163	478%	Yes	338,869
Russ Houlden(5)	97,529	73,196	85,726	118,649	243%	Yes	213,897

(1) Share price used is the average share price over the three months from 1 January 2016 to 31 March 2016 (922.8 pence per share).
(2) Unvested shares subject to no further performance conditions such as matching shares under the 'ShareBuy' scheme. Includes shares only subject to malus provisions such as the Deferred Bonus Plan shares in the three-year deferral period and Long Term Plan shares in the two-year holding period.
(3) Includes unvested shares not subject to performance conditions (on a net of tax and national insurance basis), plus the number of shares owned outright.
(4) Includes unvested shares under the Long Term Plan.
(5) In the period 1 April 2016 to 25 May 2016, additional shares were acquired by Steve Mogford (32 ordinary shares) and Russ Houlden (31 ordinary shares) in respect of their regular monthly contributions to the 'ShareBuy' scheme. These will be matched by the company on a one-for-five basis. Under the scheme, matching shares vest provided the employee remains employed by the company one year after grant.

Executive directors' share plan interests 1 April 2015 to 31 March 2016 (audited information)

	Award date	Awards held at 1 April 2015	Granted in year	Notional dividends accrued in year(1)	Exercised/ vested in year	Lapsed/ forfeited in year	Awards held at 31 March 2016	Face value of awards granted in year (£'000)	Value of shares on date vested (£'000)
Steve Mogford									
DBP	17.6.13	54,116	–	2,273	–	–	56,389	–	–
DBP(2)	30.6.14	39,487	–	1,658	–	–	41,145	–	–
DBP(3)	16.6.15	–	36,700	1,540	–	–	38,240	348(4)	–
PSP(5)	15.6.12	76,435	–	–	74,524	1,911	–	–	748(6)
MSAP(5)	15.6.12	55,044	–	–	53,667	1,377	–	–	539(6)
LTP(2)	29.7.13	127,781	–	5,367	–	–	133,148	–	–
LTP(2)	30.6.14	101,955	–	4,282	–	–	106,237	–	–
LTP	30.6.15	–	98,184	1,300	–	–	99,484	909(7)	–
MSIS (2) (8)	27.5.11	106,248	–	3,016	109,264	–	–	–	1,028(9)
ShareBuy matching shares(10)	1.4.15 to 31.3.16	41	39	–	41	–	39	0	0
TOTAL		561,107	134,923	19,436	237,496	3,288	474,682	1,257	2,315
Russ Houlden									
DBP	17.6.13	34,144	–	1,434	–	–	35,578	–	–
DBP(2)	30.6.14	24,923	–	1,046	–	–	25,969	–	–
DBP(3)	16.6.15	–	23,168	972	–	–	24,140	220(4)	–
PSP(5)	15.6.12	48,211	–	–	47,005	1,206	–	–	472(6)
MSAP(5)	15.6.12	33,931	–	–	33,082	849	–	–	332(6)
LTP(2)	29.7.13	80,642	–	3,387	–	–	84,029	–	–
LTP(2)	30.6.14	64,357	–	2,703	–	–	67,060	–	–
LTP	30.6.15	–	61,987	821	–	–	62,808	574(7)	–
MSIS(11)	16.12.10	44,962	–	1,276	46,238	–	–	–	427(12)
ShareBuy matching shares(10)	1.4.15 to 31.3.16	41	39	–	41	–	39	0	0
TOTAL		331,211	85,194	11,639	126,366	2,055	299,623	794	1,231

(1) Note that these are also subject to performance conditions where applicable.
(2) The awards held at 1 April 2015 have been restated to correct the calculation of cumulative dividend equivalents.
(3) Executive directors were required to defer 50 per cent of their 2014/15 bonus into shares for three years under the DBP. The deferral period will end on 16 June 2018. There were no service or performance conditions attached; however, deferred bonuses are subject to malus provisions (see page 87 for further information).
(4) The face value of the DBP awards made in 2015 have been calculated using the closing share price on 15 June 2015 (the dealing day prior to date of grant) which was 948.5 pence per share.
(5) 97.5 per cent of the 2012 PSP and MSAP awards vested.
(6) Calculated using the closing share price on date of vesting (19 May 2015) of 1004 pence per share.
(7) The face value of the LTP awards made in 2015 has been calculated using the closing share price on 29 June 2015 (the dealing day prior to date of grant) which was 925.5 pence per share. 25 per cent of the award vests for threshold performance and performance is measured over the period 1 April 2015 to 31 March 2018. Details of the performance measures and targets are given on page 97.
(8) Matching shares under Steve Mogford's Matched Share Investment Scheme vested on 5 January 2016. See page 95 for further detail.
(9) Calculated using the closing share price on 5 January 2016 which was 940.5 pence per share.
(10) Under ShareBuy, matching shares vest provided the employee remains employed by the company one year after grant. During the year Steve Mogford purchased 194 partnership shares and was awarded 39 matching shares (at an average share price of 927 pence per share). Russ Houlden purchased 195 partnership shares and was awarded 39 matching shares (at an average share price of 922 pence per share).
(11) Matching shares under Russ Houlden's Matched Share Investment Scheme vested on 1 October 2015. See page 95 for further details.
(12) Calculated using the closing share price on 1 October 2015 which was 924.5 pence per share.

Dates of service contracts

Executive directors	Date of service contract
Steve Mogford	5.1.11
Russ Houlden	1.10.10

Corporate governance report
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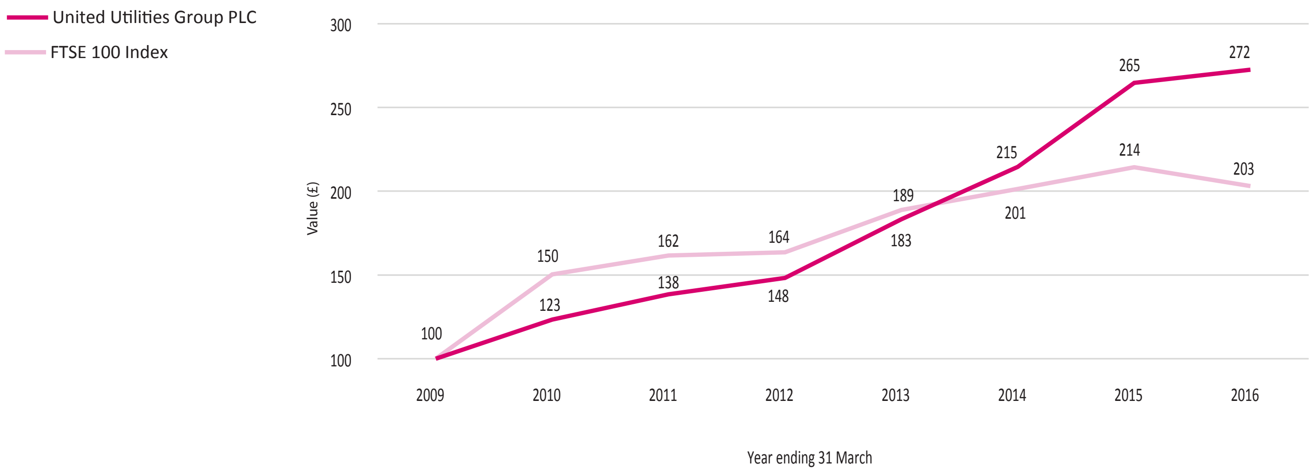
Other information

Performance and CEO remuneration comparison

This graph illustrates the company's performance against the FTSE 100 over the past seven years. The FTSE 100 has been chosen as the appropriate comparator as the company is a member of the FTSE 100 and it is considered to be the most widely published benchmark for this purpose. The table below the TSR chart shares the remuneration data for the CEO over the same seven-year period as the TSR chart.



Year ending 31 March		2010	2011	2012	2013	2014	2015	**2016**
CEO single figure of remuneration (£'000)	Steve Mogford	n/a	377	1,421	1,549	2,378	2,884	**2,830**[(1)]
	Philip Green	1,992	3,073	n/a	n/a	n/a	n/a	**n/a**
Annual bonus payment (% of maximum)	Steve Mogford	n/a	90.6	72.0	84.4	78.2	77.4	**54.5**
	Philip Green	89.2	90.8	n/a	n/a	n/a	n/a	**n/a**
Long term incentive vesting (% of maximum)[(2)]	Steve Mogford	n/a	n/a[(3)]	n/a[(3)]	n/a[(3)]	93.5	97.5	**33.6**[(4)] **100.0**[(5)]
	Philip Green	0[(6)] 12.5[(7)]	28.1[(8)] 100.0[(9)]					

(1) This includes £1.028 million in respect of Steve Mogford's one-off Matched Share Investment Scheme which ended on 5 January 2016. See page 95 for further details.
(2) For performance period ending on 31 March, unless otherwise stated.
(3) Steve Mogford was not a participant in any long-term incentive plans that had performance periods ending during 2011 to 2013. For those who did participate in those plans, the vesting as a percentage of maximum was 37.5 per cent for those vesting in 2012 and 35.3 per cent for those vesting in 2013.
(4) The 2013 Long Term Plan amount vesting percentage is estimated (see page 94 for further details).
(5) The retention period applicable to Steve Mogford's Matched Share Investment Scheme ended on 5 January 2016. See page 95 for further details.
(6) 2007 Performance Share Plan (PSP).
(7) 2007 Matching Share Award Plan (MSAP).
(8) 2008 PSP and MSAP.
(9) The retention period applicable to Philip Green's Matched Share Investment Scheme ended on 12 February 2011.

Percentage change in CEO's remuneration versus the wider workforce

The table below shows how the percentage change in the CEO's salary, benefits and bonus earned in 2014/15 and 2015/16 compares with the percentage change in the average of each of those components for a group of employees.

Item	Year-on-year change CEO (%)[(1)]	Year-on-year change employees (%)[(2)]
Base salary[(3) (4)]	2.2	3.2
Taxable benefits	0.1	1.8
Bonus	-28.1	-10.3

(1) See single total figure of remuneration table on page 91 for more information.
(2) To aid comparison, the group of employees selected by the committee are those who were employed over the complete two-year period.
(3) On 1 September 2015 Steve Mogford received a base salary increase of 2.0 per cent.
(4) Includes promotional increases.

Relative importance of spend on pay

The table below shows the relative importance of spend on pay compared to distributions to shareholders.

	2015/16	2014/15	% change
Employee costs £m[1]	**268**	260	3.1%
Dividends paid to shareholders £m	**259**	249	4.0%

(1) Employee costs includes wages and salaries, social security costs, and post-employment benefits.

Non-executive directors

Single total figure of remuneration for non-executive directors (audited information)

	Salary/fees £'000		Taxable benefits £'000		Total £'000	
	2016	2015	**2016**	2015	**2016**	2015
Dr John McAdam	**287**	281	**1**	1	**288**	282
Dr Catherine Bell	**71**	69	**1**	1	**72**	70
Stephen Carter[1]	**62**	36	**0**	1	**62**	37
Mark Clare	**75**	69	**0**	1	**75**	70
Brian May	**77**	76	**0**	1	**77**	77
Nick Salmon[2]	**n/a**	22	**n/a**	2	**n/a**	24
Sara Weller	**75**	72	**0**	0	**75**	72

(1) Stephen Carter joined the board on 1 September 2014.
(2) Nick Salmon retired from the board on 25 July 2014.

Fees

Non-executive director annual fee rates were reviewed and increased with effect from 1 September 2015 as shown below:

	Fees £'000	
Role	**1 Sept 2015**	1 Sept 2014
Base fees: Chairman[1]	**290.0**	284.0
Base fees: other non-executive directors[2]	**62.60**	61.35
Senior independent non-executive director[2]	**12.5**	12.5
Chair of audit and treasury committees[2]	**15.0**	15.0
Chair of remuneration committee[2]	**12.5**	12.5
Chair of corporate responsibility committee[2]	**10.0**	8.0

(1) Approved by the remuneration committee.
(2) Approved by a separate committee of the board.

Non-executive directors' shareholding (audited information)

Details of beneficial interests in the company's ordinary shares as at 31 March 2016 held by each of the non-executive directors and their connected persons are set out in the table below.

	Number of shares owned outright (including connected persons) at 31 March 2016 [1]
Dr John McAdam	1,837
Dr Catherine Bell	7,000
Stephen Carter	3,000
Mark Clare	7,628
Brian May	3,000
Sara Weller	10,531

(1) From 1 April 2016 to 25 May 2016 there have been no movements in the shareholdings of the non-executive directors.

Corporate governance report
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Non-executive directors	Date first appointed to the board
Dr John McAdam	4.2.08
Dr Catherine Bell	19.3.07
Stephen Carter	1.9.14
Mark Clare	1.11.13
Brian May	1.9.12
Sara Weller	1.3.12

The remuneration committee

Summary terms of reference

The committee's terms of reference were last reviewed in November 2015 and are available on our website: **corporate.unitedutilities.com/corporate-governance**

Composition of the remuneration committee

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
- Assisting the board in reporting to shareholders and undertaking appropriate discussions as necessary with institutional investors on aspects of executive remuneration

Member	Member since	Member to
Sara Weller (chair since 27.7.12)	1.3.12	To date
Dr Catherine Bell	1.3.11	To date
Mark Clare	1.9.14	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.

Advisors to the remuneration committee

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

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

During the year, the committee was assisted in its work by the following external advisor:

Advisor	Appointed by	How appointed	Services provided to the committee in year ended 31 March 2016	Fees paid by company for these services in respect of year and basis of charge
New Bridge Street	Committee	Reappointed following committee review in 2013	General advice on remuneration matters	£86,000 Time/cost basis

Other services provided to the company
– Benchmarking of roles not under the committee's remit

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

In addition, during the year the law firms Eversheds and Slaughter and May provided advice on the company's share schemes to the company.

Key activities of the remuneration committee over the past year

The committee met four times in the year ended 31 March 2016.

Regular activities

- Approved the 2014/15 directors' remuneration report
- Reviewed the base salaries of executive directors and other members of the executive team
- Reviewed the base fee for the Chairman
- Assessed the achievement of targets for the 2014/15 annual bonus scheme, reviewed progress against the targets for the 2015/16 annual bonus scheme, and set the targets in principle for the 2016/17 annual bonus scheme
- Set the targets for Long Term Plan (LTP) awards made in 2015
- Reviewed and approved awards made under the annual bonus scheme, Deferred Bonus Plan (DBP) and LTP
- 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
- Considered market trends in executive remuneration, including in the wider utilities sector

Other activities

- Completed a 'mid-term' review of policy
- Approved the treatment of unvested share awards for participants impacted by the joint venture agreement with Severn Trent which combines the two companies' non-household water and wastewater retail businesses
- Approved vesting of MSIS award and DSAS awards
- Increased shareholding guidelines to 200 per cent of salary for current and new executive directors in May 2015
- Reviewed the treatment of delisted companies in the LTP TSR comparator group

2015 AGM: Statement of voting

At the last Annual General Meeting on 24 July 2015, votes on the directors' remuneration report were cast as follows:

	For		Against		Abstain
Resolution	%	Number	%	Number	Number
Approval of the 2014/15 directors' remuneration report (other than the part containing the directors' remuneration policy)	99.50	391,311,284	0.50	1,958,225	3,946,108

The directors' remuneration report was approved by the board of directors on 25 May 2016 and signed on its behalf by:

Sara Weller
Chair of the remuneration committee

Corporate governance report
Tax policies and objectives

Consistent with our wider business objectives, we are committed to acting in a responsible manner in relation to our tax affairs.

Our tax policies and objectives, which are approved by the board on an annual basis, ensure that we:

- only engage in reasonable tax planning aligned with our commercial activities and we always comply with what we believe to be both the letter and the spirit of the law;
- do not engage in aggressive or abusive tax avoidance;
- are committed to an open, transparent and professional relationship with HMRC based on mutual trust and collaborative working; and
- maintain a robust governance and risk management framework to ensure that these policies and objectives are applied at all levels.

In line with the above, we expect to fully adhere to the new HMRC framework for co-operative compliance.

Under the regulatory framework the group operates within, the majority of any benefit from reduced tax payments will typically not be retained by the group but will pass to customers via reduced bills.

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

Consistent with the group's general risk management framework, any tax risks are assessed for the likelihood of occurrence and the negative financial or reputational impact on the group and its objectives, should the event occur. In any given period, the key tax risk is likely to be the introduction of unexpected legislative or tax practice changes which lead to increased cash outflow which has not been reflected in the current regulatory settlement. The group is committed to actively engaging with relevant authorities in order to actively manage any such risk.

The group's principal subsidiary, United Utilities Water Limited (UUW), operates solely in the UK and its customers are based here. All of the group's profits are taxable in the UK (other than the group's 35 per cent holding in Tallinn Water which typically generates around £5 million profit before tax with around £1 million Estonian tax paid).

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £130–140 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees, such as water abstraction charges.

We expect the above details, which apply for both financial years ended 31 March 2016 and 31 March 2017, to fully comply with the new legislative requirements for 'Publication of Group Tax Strategies' for UK groups.

Directors' report: statutory and other information

Gross carbon emissions for 2015/16

454,857

tonnes CO_2 equivalent
22.4 per cent below our 2005/06 baseline

138 GWh

of renewable generation in 2015/16 – equivalent to 17 per cent of our electricity consumption

Our directors present their management report including the strategic report on pages 4 to 49 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 2016.

Business model

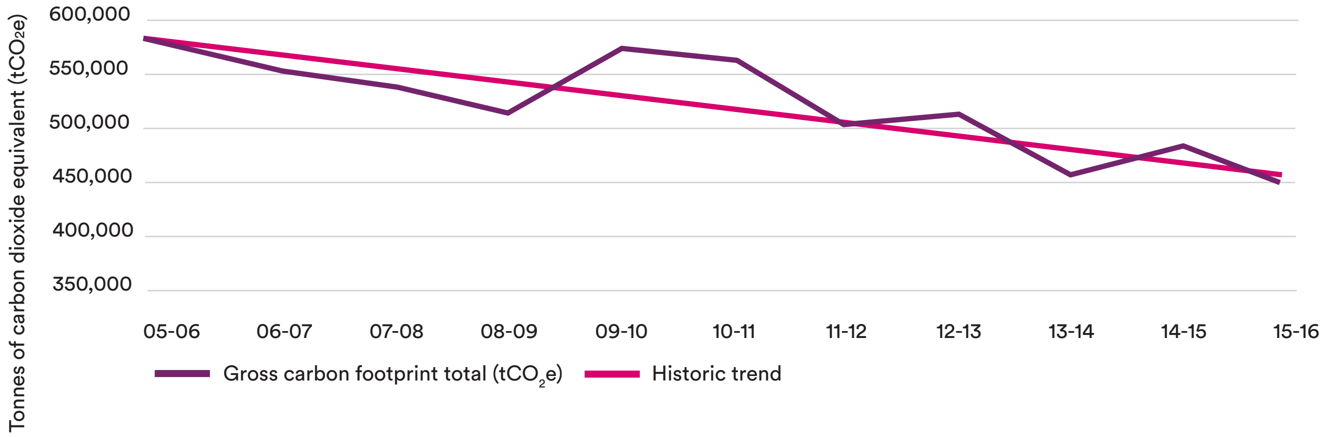
A description of the company's business model can be found within the strategic report on pages 10 to 26.

Carbon

We measure our emissions over the financial reporting year against a footprint covering the operational activities of the water, wastewater and property services businesses in the UK. All figures stated are in line with the latest UK Government carbon reporting guidance. Our reporting is compliant with the international carbon reporting standard (ISO 14064, Part 1) and assured by the Certified Emissions Measurement and Reduction Scheme (CEMARS).

Our performance in 2015/16 was 454,857 tCO_2e which is 22.4 per cent below the 2005/06 baseline. The trend in our overall emissions continues to be downwards even though it has fluctuated over the past few years – as it can be affected by weather, operational conditions and the carbon content of the UK's electricity supply.

Our carbon footprint over the last 11 years



We expect the overall trend in our emissions to remain downwards reflecting our efforts to use less energy and increase renewable energy generation, alongside projected decreases in the carbon content of the UK's energy supply. In 2015/16, the reduction in the carbon intensity of UK grid electricity offset the small increase in our consumption of grid electricity, whilst natural gas consumption saw a small decrease. An improvement in sludge and process emissions was offset by Defra's change to the Global Warming Potential (GWP) factor for methane, which increased by nearly 20 per cent this year. Exceptional weather and operational conditions reduced renewable electricity generation from our CHP fleet by 12 per cent below target, whilst our investment in wind and solar photovoltaics saw an additional 4.36 GWh of electricity generation.

Directors' report: statutory and other information

CO_2 CH_4 N_2O SF_6 HFCs PFCs

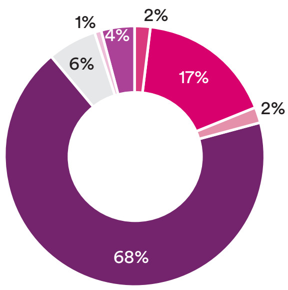
SCOPE 1 (Direct)
- Process emissions including refrigerants
- Fossil fuel use
- Company vehicles

SCOPE 2 (Indirect)
- Purchased electricity (generation)

SCOPE 3 (Indirect)
- Purchased electricity (transmission and distribution)
- Sludge and process waste disposal
- Public transport and mileage

Outside of boundary:
contractor emissions, supplier emissions, customer emissions

Emissions



- Direct emissions from burning of fossil fuels
- Process and emissions from our treatment plants – including refrigerants
- Transport: company owned or leased vehicles
- Total grid electricity used by company: generation
- Total grid electricity used by company: transmission and distribution
- Business travel on public transport and private vehicles used for company business
- Emissions from sludge/process waste disposal

The boundary of our carbon footprint includes both direct and indirect emissions as a result of our operations.

– Direct emissions include those from our treatment processes, company vehicles and burning of fossil fuels for heating or incineration of sewage sludge.

– Indirect emissions include those from the electricity we use to power our treatment plants, emissions from travel on company business and sludge and treatment waste disposal emissions. Our emissions account for all of the Kyoto Protocol gases – converted to carbon dioxide equivalents. There are no material omissions.

The following table gives a breakdown of our carbon emissions by scope and source:

CHG Scope	Source	2013/14 (tCO_2e)	2014/15 (tCO_2e)	2015/16 (tCO_2e)
Scope 1 emissions	Direct emissions from burning of fossil fuels	9,525	9,575	12,283
	Process emissions from our treatment plants – including refrigerants	82,421	83,762	87,004
	Transport: company owned or leased vehicles	10,046	10,704	11,246
Scope 2 emissions	Total grid electricity purchased by the company: generation	298,768	321,185	302,791
Scope 3 emissions	Total grid electricity purchased by the company: transmission and distribution	25,546	28,086	25,006
	Business travel on public transport and private vehicles used for company business	2,860	2,971	2,783
	Emissions from sludge and process waste disposal	19,875	17,425	13,744
	Gross carbon footprint total	**449,041**	**473,708**	**454,857**
	Emission reductions from exported renewable electricity	(6,676)	(6,155)	(4,209)
	Net carbon footprint total	**442,365**	**467,553**	**450,648**
	Emissions per £million turnover	263.44	275.44	262.92

Dividends	Our directors are recommending a final dividend of 25.64 pence per ordinary share for the year ended 31 March 2016, which, together with the interim dividend of 12.81 pence, gives a total dividend for the year of 38.45 pence per ordinary share (the interim and final dividends we paid in respect of the 2014/15 financial year were 12.56 pence and 25.14 pence per ordinary share respectively). Subject to approval by our shareholders at our AGM, our final dividend will be paid on 1 August 2016 to shareholders on the register at the close of business on 24 June 2016.
Directors	The biographical details, together with the skills and experience, of our directors who served during the financial year ended 31 March 2016 can be found on pages 52 and 53.
Reappointment	Our articles of association provide that our directors must retire at the third annual general meeting following their last election or reappointment by our shareholders. However, our board, being mindful of the recommendation contained within the UK Corporate Governance Code published in 2014 ('the Code') that all directors should be subject to annual election by shareholders, has decided that all of our directors will retire at AGMs and offer themselves for election/reappointment, as has happened at all the AGMs since 2011. Information regarding the appointment of our directors is included in our corporate governance report on pages 64 to 67. Dr Catherine Bell is not seeking reappointment at the 2016 AGM.
Interests	Details of the interests in the company's shares held by our directors and persons connected with them are set out in our directors' remuneration report on pages 82 to 101 which is hereby incorporated by reference into this directors' report.
Corporate governance statement	The corporate governance report on pages 50 to 102 is hereby incorporated by reference into this directors' report and includes details of our compliance with the Code. Our statement includes a description of the main features of our internal control and risk management systems in relation to the financial reporting process and forms part of this directors' report. A copy of the Code, as applicable to the company for the year ended 31 March 2016, can be found at the Financial Reporting Council's website frc.org.uk. Copies of the matters reserved for the board and the terms of reference for each of the main board committees can be found on our website. Our corporate governance statement also includes the consideration given by our directors to the factors relevant to the provision of a long-term viability statement. We can confirm that during the financial year 2015/2016 there have been no breaches of our anti-bribery and competition policies and no investigations or enforcement activity against us in respect of these matters.
Share capital	At 31 March 2016, the issued share capital of the company was £499,819,926 divided into 681,888,418 ordinary shares of 5 pence each and 273,956,180 deferred shares of 170 pence each. Details of our share capital and movements in our issued share capital are shown in note 22 to the financial statements on page 138. 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 2016. All our ordinary shares have the same rights, including the rights to one vote at any of our general meetings, to an equal proportion of any dividends we declare and pay, and to an equal amount of any surplus assets which are distributed in the event of a winding-up. Our deferred shares convey no right to income, no right to vote and no appreciable right to participate in any surplus capital in the event of a winding-up. The rights attaching to our shares in the company are provided by our articles of association, which may be amended or replaced by means of a special resolution of the company in general meeting. The company renews annually its power to issue and buy back shares at our AGM and such resolutions will be proposed at our 2016 AGM. Our directors' powers are conferred on them by UK legislation and by the company's articles. At the AGM of the company on 24 July 2015, the directors were authorised to issue relevant securities up to an aggregate nominal amount of £11,364,806 and were empowered to allot equity securities for cash on a non pre-emptive basis to an aggregate nominal amount of £1,704,721.

Directors' report: statutory and other information

Voting	Electronic and paper proxy appointment and voting instructions must be received by our registrars (Equiniti) not less than 48 hours before a general meeting and when calculating this period, the directors can decide not to take account of any part of a day that is not a working day.
Transfers	There are no restrictions on the transfer of our ordinary shares in the company, nor any limitations on the holding of our shares in the company, save (i) where the company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the company with information requested by it in accordance with Part 22 of the Companies Act 2006; or (ii) where their holder is precluded from exercising voting rights by the Financial Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers. There are no agreements known to us between holders of securities that may result in restrictions on the transfer of securities or on voting rights. All our issued shares are fully paid.
Major shareholdings	At 25 May 2016, our directors had been notified of the following interests in the company's issued ordinary share capital in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority:

	Per cent of issued share capital	Direct or indirect nature of holding
Legal & General Group Plc	3.02	direct
BlackRock Inc	5.13	indirect

Purchase of own shares	At our last AGM held on 24 July 2015, our shareholders authorised the company to purchase, in the market, up to 68,188,841 of our ordinary shares of 5 pence each. We did not purchase any shares under this authority during the year. We normally seek such an authority from our shareholders annually. At our 2016 AGM, we will seek authority from our shareholders to purchase up to 68,188,841 of our ordinary shares of 5 pence each with such authority expiring at the end of our AGM held in 2017.
Change of control	As at 31 March 2016, Equiniti Trust (Jersey) Limited was the trustee that administered our executive share plans and had the ability to exercise voting rights at its discretion which related to shares that it held under the trust deed constituting the trust. In the event of a takeover offer which could lead to a change of control of the company, the trustee must consult with the company before accepting the offer or voting in favour of the offer. Subject to that requirement, the trustee may take into account a prescribed list of interests and considerations prior to making a decision in relation to the offer, including the interests of the beneficiaries under the trust. In the event of a change of control, the participants in our share incentive plan (ShareBuy) would be able to direct the trustee of the share incentive plan, Equiniti Share Plan Trustees Limited, how to act on their behalf.
Information required by UK listing rule 9.8.4	Details of the amount of interest capitalised by the group during the financial year can be found in note 5 to the financial statements on page 127. In line with current UK tax legislation, the amount is fully deductible against the group's corporation tax liability resulting in tax relief of £4.3 million. There are no other disclosures to be made under listing rule 9.8.4.
Directors' indemnities and insurance	We have in place contractual entitlements for the directors of the company and of its subsidiaries to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third party indemnity provision and qualifying pension scheme indemnity provision, have been established in compliance with the relevant provisions of the Companies Act 2006 and have been in force throughout the financial year. They include provision for the company to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of the company or its subsidiaries. The company also maintains an appropriate level of directors' and officers' liability insurance.

Political donations	We do not support any political party and do not make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the group and our political stakeholders. This includes promoting United Utilities' activities at the main political parties' annual conferences, and occasional stakeholder engagement in Westminster. The group incurred expenditure of £5,360 (2015: £21,600) as part of this process. At the 2015 AGM, an authority was taken to cover such expenditure. A similar resolution will be put to our shareholders at the 2016 AGM to authorise the company and its subsidiaries to make such expenditure.
Employees	Our policies on employee consultation and on equal opportunities for our disabled employees can be found in the 'People' section on page 14. The company's business principles make clear how it and all our employees must seek to act with integrity and fairness and observe legal requirements. Anyone with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or through a confidential telephone line. Importance is placed on strengthening employees' engagement, measuring their views annually, then taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information to enable them to understand the financial and economic factors affecting the company's performance. The board encourages employees to own shares in the company through the all employee share incentive plan (ShareBuy). For further information on our average number of employees during the year, go to note 2 on page 125.
Environmental, social and community matters	Details of our approach to corporate responsibility, relating to the environment and social and community issues, can be found on pages 80 and 81.
Essential contractual relationships	Certain suppliers we use contribute key goods or services, the loss of which could cause disruption to our services. However, none are so vital that their loss would affect our viability as a group as a whole nor are we overly dependent on any one individual customer.
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 our investment on the development of technology and that we have the right skills to apply technology to achieve sustainable competitive advantage and also that we continue to be alert to emerging technological opportunities.
Financial instruments	Our risk management objectives and policies in relation to the use of financial instruments can be found in note A4 to the financial statements.
Events occurring after the reporting period	Details of events after the reporting period are included in note 25 to the consolidated financial statements on page 138.
Slavery and Human Trafficking Statement 2016	Our 2016 statement can be found on our website at **corporate.unitedutilities.com/slavery-human-trafficking**

Directors' report: statutory and other information

Total dividend per share

38.45p

for 2015/16
(2014/15: 37.70p per share)

Annual general meeting

Our 2016 annual general meeting (AGM) will be held on 22 July.

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

Read more online at **corporate.unitedutilities.com/annual-general-meeting-2016**

At our 2016 AGM, resolutions will be proposed, amongst other matters:

– to receive the annual report and financial statements; to approve the directors' remuneration report; to declare a final dividend; and to reappoint KPMG LLP as auditor.

– 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 working days' notice.

Information given to the auditor

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

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

– 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 the auditor

Our board is proposing that our shareholders reappoint KPMG LLP as our auditor at the forthcoming AGM and authorises the audit committee of the board to set the auditor's remuneration.

Approved by the board on 25 May 2016 and signed on its behalf by:

Simon Gardiner
Company Secretary

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

The directors are responsible for preparing the annual report and the group and parent company financial statements in accordance with applicable laws and regulations.

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

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

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

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

Under applicable law and regulations, the directors are also responsible for preparing a strategic report, 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

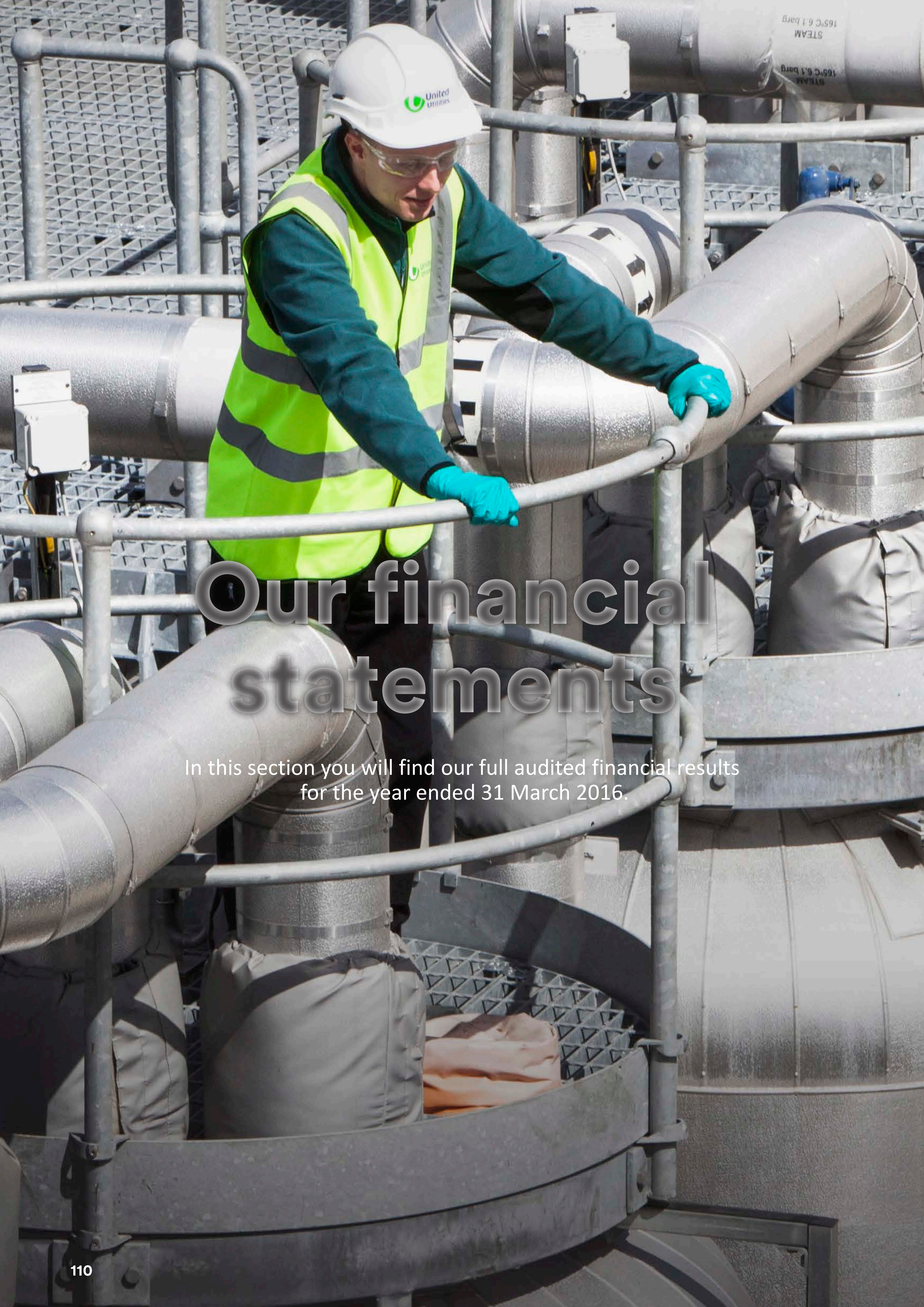
We confirm that to the best of our knowledge:

– 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;
– the strategic report (contained on pages 4 to 49) 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; and
– the directors consider the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position, performance, business model and strategy.

Approved by the board on 25 May 2016 and signed on its behalf by:

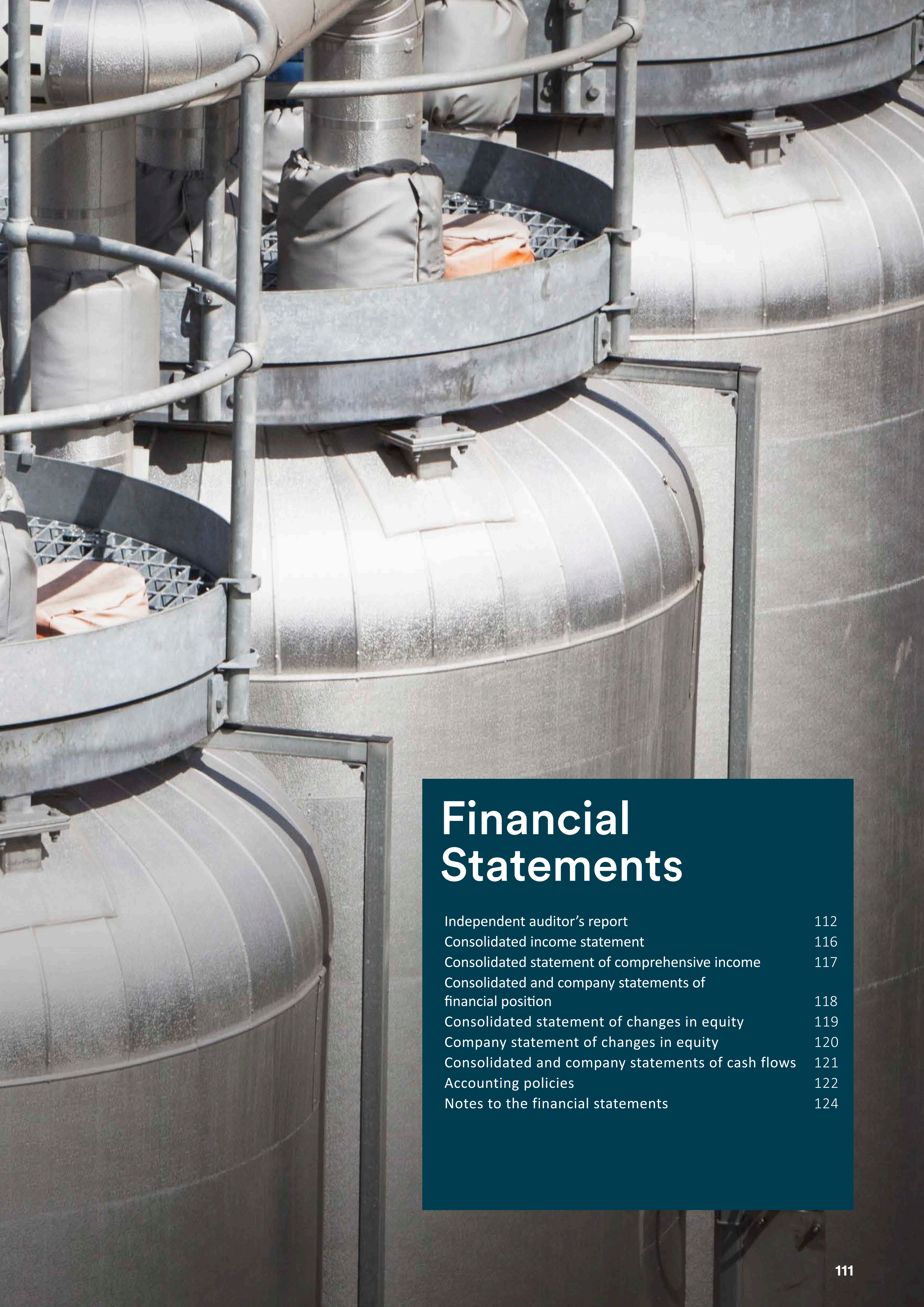
Dr John McAdam
Chairman

Russ Houlden
Chief Financial Officer



Our financial statements

In this section you will find our full audited financial results for the year ended 31 March 2016.



Financial Statements

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

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of United Utilities Group PLC for the year ended 31 March 2016 set out on pages 116 to 161. In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows (unchanged from 2015):

Revenue recognition £1,730.0 million (2015: £1,720.2 million) and provision for customer debts £94.4 million (2015: £100.5 million)

Refer to page 77 audit committee report, pages 122 to 123 accounting policies and note 14 financial disclosures.

The risk

Revenue recognition and provision for customer debts are key areas of judgement, particularly in relation to:

- the estimate of the revenue value of water supplied to metered customers between the last meter reading and the period end; and
- identifying properties where there is little prospect cash will be received for revenue that has been billed due to either the occupier not being able to be identified or a past history of non-payment of bills relating to that property; and
- assessing the recoverability of trade debtors as a proportion of customers do not or are unable to pay their bills.

Our response

Our audit procedures included:

- assessing whether appropriate revenue recognition policies are applied through comparison with relevant accounting standards and industry practice, including the policy of not recognising revenue where it is not probable that cash will be received;
- testing the group's controls over revenue recognition and provision for customer debts, including reconciliations between sales and cash receipts systems and the general ledger;
- assessing the assumptions used to calculate the metered accrued income by ensuring inputs to the calculation have been derived appropriately and recalculating the accrued income with the support of our own modelling specialists;
- assessing the appropriateness of the customer debt provisioning policy based on historical cash collections, credits, re-bills and write off information; and
- assessing the adequacy of the group's disclosures of its revenue recognition and customer debt provisioning policies, including the estimation uncertainty involved in recording revenue and the bad debt provision.

Capital expenditure £665.8 million (2015: £728.5 million)

Refer to page 77 audit committee report, page 122 accounting policies and note 9 financial disclosures.

The risk	Our response
The group has a substantial capital programme which has been agreed with the Water Services Regulation Authority (Ofwat) and therefore incurs significant annual expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred. Capital projects often contain a combination of enhancement and maintenance activity which are not distinct and therefore the allocation of costs between capital and operating expenditure is inherently judgemental. The costs capitalised include an allocation of overhead costs, relating to the proportion of time spent by support function staff, which is also inherently judgemental and could lead to over capitalisation of expenses.	Our audit procedures included: – assessing the group's capitalisation policy for compliance with relevant accounting standards; – testing controls over the application of the policy to spend incurred in the period including attending capital approval meetings to observe the judgements made and evaluating the documented final conclusions; – critically assessing the costs capitalised for a sample of projects against the capitalisation policy, focusing on those where actual costs differed significantly to budget; – agreeing overhead costs incurred to supporting documentation on a sample basis and performed comparative analysis of overheads absorbed into capital projects by category; – testing a sample of capital accruals to assess the existence of the costs being capitalised through review of ageing of specific project accruals; and – assessing the adequacy of the group's disclosures of its capitalisation policy and other related disclosures.

Retirement benefit surplus £275.2 million (2015: £79.2 million)

Refer to page 77 audit committee report, page 123 accounting policies and notes 18 and A5 financial disclosures.

The risk	Our response
Significant estimates are made in valuing the group's retirement benefit surplus. Small changes in assumptions and estimates used to value the group's pension obligation (before deducting scheme assets) would have a significant effect on the group's financial position.	Our audit procedures included: – challenging the key assumptions supporting the group's retirement benefit obligations valuation with input from our own actuarial specialists, including comparing the discount rate, inflation rate, salary, pension increase rates and life expectancy assumptions used against externally derived data; and – assessing the group's disclosure in respect of the sensitivity of the surplus to changes in the key assumptions.

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

Derivative financial instrument valuations £503.9 million (2015: £477.4 million)

Refer to page 77 audit committee report, page 123 accounting policies and note A4 financial disclosures.

The risk	Our response
The group has significant derivative financial instruments, the valuation of which is determined through the application of valuation techniques which often involve the exercise of judgement and the use of assumptions and estimates. Due to the significance of financial instruments and the related estimation uncertainty, there is a risk that the related financial assets and liabilities are misstated.	Our audit procedures included: – assessing controls over the identification, measurement and management of derivative financial instruments; – evaluating the methodologies, inputs and assumptions used by the group in determining fair values, with the help of our own valuation specialist; – challenging the observable inputs into valuation models, such as quoted prices, by reference to externally available market data to assess whether appropriate inputs are used in the valuation; – comparing valuations derived from our internal valuation model for a sample of instruments to the fair values determined by the group; – considering the adequacy of the group's disclosures about the valuation basis and inputs used in the fair value measurement; and – assessing whether the financial statement disclosures of fair value risks and sensitivities appropriately reflect the group's exposure to valuation risk.

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

Materiality for the group financial statements as a whole was set at £20.0 million (2015: £25.0 million), determined with reference to a benchmark of group profit before tax, normalised to exclude net fair value losses on debt and derivative instruments (see note 5) and the adjusting item relating to a one-off water quality incident (see note 3). Materiality represents 4.9 per cent (2015: 5.6 per cent) of normalised group profit before tax, reflecting industry consensus levels. Specific audit procedures have been performed over items excluded from the normalised profit before tax.

We report to the audit committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2015: £0.5 million), in addition to other identified misstatements that warrant reporting on qualitative grounds.

Of the group's six (2015: five) reporting components, we subjected five (2015: four) to audit, of which the most significant is United Utilities Water Limited which makes up the vast majority of the assets, liabilities, income and expense of the group. These components covered 99 per cent of group revenue (2015: 99 per cent), 100 per cent of group profit before tax (2015: 100 per cent) and 100 per cent of group total assets (2015: 99 per cent). The audit work on these components was performed by the group team. For the remaining component, we performed an analysis at group level to re-examine our assessment that there were no significant risks of material misstatements within this.

The component materialities ranged from £1.2 million for the smallest component to £19.0 million for United Utilities Water Limited, determined having regard to the mix of size and risk profile of the group across the components.

4. Our opinion on the other matter prescribed by the Companies Act 2006 is unmodified

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 strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

– information given in the corporate governance statement set out on pages 50 to 102 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.

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

– the directors' viability statement on page 71 concerning the principal risks, their management and, based on that, the directors' assessment and expectations of the group continuing in operation over the five years to 31 March 2021; or

– the disclosures on page 122 in the accounting policies' note to the financial statements concerning the use of the going concern basis of accounting.

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

Under International Standards on Auditing (UK and Ireland) (ISAs) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

– we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy; or

– the audit committee section of the corporate governance report does not appropriately address matters communicated by us to the audit committee.

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, set out on page 71, in relation to going concern; and

– the part of the corporate governance statement on pages 50 to 102 relating to the company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope of responsibilities

As explained more fully in the directors' responsibilities statement set out on page 109, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

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

Consolidated income statement for the year ended 31 March

	Note	2016 £m	2015 £m
Revenue	1	**1,730.0**	1,720.2
Employee benefits expense	2	**(146.9)**	(145.1)
Other operating costs	3	**(485.8)**	(424.3)
Other income	3	**3.6**	3.3
Depreciation and amortisation expense	3	**(363.7)**	(352.6)
Infrastructure renewals expenditure		**(169.3)**	(148.2)
Total operating expenses		**(1,162.1)**	(1,066.9)
Operating profit		**567.9**	653.3
Investment income	4	**5.0**	1.0
Finance expense	5	**(224.4)**	(317.8)
Investment income and finance expense		**(219.4)**	(316.8)
Share of profits of joint ventures		**5.0**	5.1
Profit before tax		**353.5**	341.6
Current tax charge	6	**(44.3)**	(47.1)
Deferred tax charge	6	**(24.2)**	(23.3)
Deferred tax credit – change in tax rate	6	**112.5**	–
Tax	6	**44.0**	(70.4)
Profit after tax		**397.5**	271.2
Earnings per share			
Basic	7	**58.3p**	39.8p
Diluted	7	**58.2p**	39.7p
Dividend per ordinary share	8	**38.45p**	37.70p

All of the results shown above relate to continuing operations.

Consolidated statement of comprehensive income for the year ended 31 March

	Note	2016 £m	2015 £m
Profit after tax		**397.5**	271.2
Other comprehensive income			
Remeasurement gains on defined benefit pension schemes	18	**160.1**	250.5
Tax on items taken directly to equity	6	**(26.5)**	(50.1)
Foreign exchange adjustments		**3.0**	(3.1)
Total comprehensive income		**534.1**	468.5

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

Consolidated and company statements of financial position at 31 March

		Group		Company	
	Note	2016 £m	2015 £m	2016 £m	2015 £m
ASSETS					
Non-current assets					
Property, plant and equipment	9	**10,031.4**	9,716.3	**–**	–
Intangible assets	10	**162.4**	144.9	**–**	–
Interests in joint ventures	11	**35.1**	31.7	**–**	–
Investments	12	**8.7**	8.6	**6,326.8**	6,326.8
Trade and other receivables	14	**2.5**	2.5	**–**	–
Retirement benefit surplus	18	**275.2**	79.2	**–**	–
Derivative financial instruments	A4	**765.5**	681.6	**–**	–
		11,280.8	10,664.8	**6,326.8**	6,326.8
Current assets					
Inventories	13	**29.3**	40.5	**–**	–
Trade and other receivables	14	**367.4**	353.3	**62.5**	61.2
Cash and short-term deposits	16	**213.6**	244.0	**–**	–
Derivative financial instruments	A4	**0.1**	1.0	**–**	–
Assets classified as held for sale	15	**15.6**	–	**–**	–
		626.0	638.8	**62.5**	61.2
Total assets		**11,906.8**	11,303.6	**6,389.3**	6,388.0
LIABILITIES					
Non-current liabilities					
Trade and other payables	21	**(530.5)**	(480.0)	**–**	–
Borrowings	17	**(6,508.8)**	(6,067.3)	**(1,636.9)**	(1,609.4)
Deferred tax liabilities	19	**(1,062.0)**	(1,123.8)	**–**	–
Derivative financial instruments	A4	**(255.8)**	(196.6)	**–**	–
		(8,357.1)	(7,867.7)	**(1,636.9)**	(1,609.4)
Current liabilities					
Trade and other payables	21	**(341.7)**	(381.2)	**(11.1)**	(10.8)
Borrowings	17	**(469.2)**	(578.1)	**(0.5)**	(0.4)
Current tax liabilities		**(12.3)**	(21.1)	**–**	–
Provisions	20	**(15.1)**	(12.5)	**–**	–
Derivative financial instruments	A4	**(5.9)**	(8.6)	**–**	–
		(844.2)	(1,001.5)	**(11.6)**	(11.2)
Total liabilities		**(9,201.3)**	(8,869.2)	**(1,648.5)**	(1,620.6)
Total net assets		**2,705.5**	2,434.4	**4,740.8**	4,767.4
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	22	**499.8**	499.8	**499.8**	499.8
Share premium account		**2.9**	2.9	**2.9**	2.9
Cumulative exchange reserve		**(5.7)**	(8.7)	**–**	–
Capital redemption reserve		**–**	–	**1,033.3**	1,033.3
Merger reserve		**329.7**	329.7	**–**	–
Retained earnings		**1,878.8**	1,610.7	**3,204.8**	3,231.4
Shareholders' equity		**2,705.5**	2,434.4	**4,740.8**	4,767.4

These financial statements for the group and United Utilities Group PLC (company number: 6559020) were approved by the board of directors on 25 May 2016 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

	Share capital £m	Share premium account £m	Other reserve £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2015	**499.8**	**2.9**	**–**	**(8.7)**	**329.7**	**1,610.7**	**2,434.4**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**397.5**	**397.5**
Other comprehensive income							
Remeasurement gains on defined benefit pension schemes (see note 18)	**–**	**–**	**–**	**–**	**–**	**160.1**	**160.1**
Tax on items taken directly to equity (see note 6)	**–**	**–**	**–**	**–**	**–**	**(26.5)**	**(26.5)**
Foreign exchange adjustments	**–**	**–**	**–**	**3.0**	**–**	**–**	**3.0**
Total comprehensive income	**–**	**–**	**–**	**3.0**	**–**	**531.1**	**534.1**
Dividends (see note 8)	**–**	**–**	**–**	**–**	**–**	**(258.7)**	**(258.7)**
Transfer of other reserve	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Equity-settled share-based payments (see note 2)	**–**	**–**	**–**	**–**	**–**	**2.3**	**2.3**
Exercise of share options – purchase of shares	**–**	**–**	**–**	**–**	**–**	**(6.6)**	**(6.6)**
At 31 March 2016	**499.8**	**2.9**	**–**	**(5.7)**	**329.7**	**1,878.8**	**2,705.5**

	Share capital £m	Share premium account £m	Other reserve £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2014	499.8	2.9	158.8	(5.6)	329.7	1,230.3	2,215.9
Profit after tax	–	–	–	–	–	271.2	271.2
Other comprehensive (expense)/income							
Remeasurement gains on defined benefit pension schemes (see note 18)	–	–	–	–	–	250.5	250.5
Tax on items taken directly to equity (see note 6)	–	–	–	–	–	(50.1)	(50.1)
Foreign exchange adjustments	–	–	–	(3.1)	–	–	(3.1)
Total comprehensive (expense)/income	–	–	–	(3.1)	–	471.6	468.5
Dividends (see note 8)	–	–	–	–	–	(249.4)	(249.4)
Transfer of other reserve	–	–	(158.8)	–	–	158.8	–
Equity-settled share-based payments (see note 2)	–	–	–	–	–	2.9	2.9
Exercise of share options – purchase of shares	–	–	–	–	–	(3.5)	(3.5)
At 31 March 2015	499.8	2.9	–	(8.7)	329.7	1,610.7	2,434.4

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

The merger reserve arose in the year ended 31 March 2009 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 statement of changes in equity for the year ended 31 March

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2015	**499.8**	**2.9**	**1,033.3**	**3,231.4**	**4,767.4**
Profit after tax	–	–	–	**236.4**	**236.4**
Total comprehensive income	–	–	–	**236.4**	**236.4**
Dividends (see note 8)	–	–	–	**(258.7)**	**(258.7)**
Equity-settled share-based payments (see note 2)	–	–	–	**2.3**	**2.3**
Exercise of share options – purchase of shares	–	–	–	**(6.6)**	**(6.6)**
At 31 March 2016	**499.8**	**2.9**	**1,033.3**	**3,204.8**	**4,740.8**

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2014	499.8	2.9	1,033.3	2,525.9	4,061.9
Profit after tax	–	–	–	955.5	955.5
Total comprehensive income	–	–	–	955.5	955.5
Dividends (see note 8)	–	–	–	(249.4)	(249.4)
Equity-settled share-based payments (see note 2)	–	–	–	2.9	2.9
Exercise of share options – purchase of shares	–	–	–	(3.5)	(3.5)
At 31 March 2015	499.8	2.9	1,033.3	3,231.4	4,767.4

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The result of the company for the financial year was a profit after tax of £236.4 million (2015: £955.5 million) after accounting for a £nil (2015: £726.8 million) reversal of the impairment in the company's investment in United Utilities PLC and dividends received from subsidiary undertakings of £258.7 million (2015: £249.4 million).

Consolidated and company statements of cash flows for the year ended 31 March

		Group		Company	
	Note	**2016 £m**	2015 £m	**2016 £m**	2015 £m
Operating activities					
Cash generated from operations	A1	**905.5**	941.7	**261.3**	256.1
Interest paid		**(168.7)**	(175.6)	**(27.5)**	(25.7)
Interest received and similar income		**1.9**	1.0	**–**	–
Tax paid		**(53.1)**	(61.9)	**–**	–
Tax received		**–**	1.3	**5.5**	7.1
Net cash generated from operating activities		**685.6**	706.5	**239.3**	237.5
Investing activities					
Purchase of property, plant and equipment		**(634.2)**	(665.7)	**–**	–
Purchase of intangible assets		**(66.1)**	(63.4)	**–**	–
Proceeds from sale of property, plant and equipment		**1.4**	2.0	**–**	–
Grants and contributions received	21	**17.3**	18.1	**–**	–
Purchase of investments	12	**–**	(0.8)	**–**	–
Proceeds from investments	12	**0.2**	–	**–**	–
Dividends received from joint ventures		**4.6**	4.9	**–**	–
Net cash used in investing activities		**(676.8)**	(704.9)	**–**	–
Financing activities					
Proceeds from borrowings		**693.0**	411.2	**25.9**	15.6
Repayment of borrowings		**(474.1)**	(19.1)	**–**	–
Dividends paid to equity holders of the company	8	**(258.7)**	(249.4)	**(258.7)**	(249.4)
Exercise of share options – purchase of shares		**(6.6)**	(3.5)	**(6.6)**	(3.5)
Net cash (used in)/generated from financing activities		**(46.4)**	139.2	**(239.4)**	(237.3)
Net (decrease)/increase in cash and cash equivalents		**(37.6)**	140.8	**(0.1)**	0.2
Cash and cash equivalents at beginning of the year		**219.7**	78.9	**(0.4)**	(0.6)
Cash and cash equivalents at end of the year	16	**182.1**	219.7	**(0.5)**	(0.4)

Accounting policies

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

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). They have been prepared on the historical cost basis, except for the revaluation of financial instruments, accounting for the transfer of assets from customers and the revaluation of infrastructure assets to fair value on transition to IFRS.

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

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

In assessing the appropriateness of the going concern basis of accounting the directors have reviewed the resources available to the group, taking account of the group's financial projections, together with available cash and committed borrowing facilities as well as consideration of the group's capital adequacy, consideration of the primary legal duty of UUW's economic regulator to ensure that water and wastewater companies can finance their functions, and any material uncertainties. The board has also considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of mitigating actions that the directors would consider undertaking.

Adoption of new and revised standards

The following standards, interpretations and amendments, effective for the year ended 31 March 2016, have had no material impact on the group's financial statements.

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

Critical accounting judgements and key sources of estimation uncertainty

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

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

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

Property, plant and equipment

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

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

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

Revenue recognition and allowance for doubtful receivables

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

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

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

Provisions and contingencies

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

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 24, unless the possibility of transferring economic benefits is remote.

Retirement benefits

The group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note A5. Profit before tax and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions. It should be noted that actual rates may differ from the assumptions used due to changing market and economic conditions and longer or shorter lives of participants.

Derivative financial instruments

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

Tax

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

New and revised standards not yet effective

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

IFRS 9 'Financial Instruments'

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

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

IFRS 16 'Leases'

The standard is effective for periods commencing on or after 1 January 2019 but has not yet been endorsed by the EU. Under the provisions of the standard most leases, including the majority of those previously classified as operating leases, will be brought onto the statement of financial position, as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 'Property, Plant and Equipment' and the liability increased for the accretion of interest and reduced by lease payments.

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

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

Notes to the financial statements

1 Revenue and segment reporting

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

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

The board 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 (see page 44), operating profit, assets and liabilities, regulatory capital expenditure and regulatory capital value (RCV) gearing at a consolidated level. In light of this, the group has a single segment for financial reporting purposes and therefore no further detailed segmental information is provided in this note.

2 Directors and employees

Directors' remuneration

	2016 £m	2015 £m
Fees to non-executive directors	0.6	0.6
Salaries	1.2	1.1
Benefits	0.3	0.3
Bonus	0.4	0.6
Share-based payment charge	1.0	1.3
	3.5	3.9

Further information about the remuneration of individual directors and details of their pension arrangements are provided in the directors' remuneration report on pages 82 to 101.

Remuneration of key management personnel

	2016 £m	2015 £m
Salaries and short-term employee benefits	4.9	5.9
Post-employment benefits	0.1	0.2
Share-based payment charge	1.8	2.4
	6.8	8.5

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

Employee benefits expense (including directors)

Group	2016 £m	2015 £m
Wages and salaries	212.7	206.5
Social security	19.1	18.1
Severance	(0.2)	6.6
Post-employment benefits:		
Defined benefit pension expense (see note 18)	26.1	26.2
Defined contribution pension costs (see note 18)	9.9	8.8
	36.0	35.0
Charged to regulatory capital schemes	(120.7)	(121.1)
Employee benefits expense	146.9	145.1

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

2 Directors and employees continued

The total expense included within employee benefits expense in respect of equity-settled share-based payments was £2.3 million (2015: £2.9 million). The company operates several share option schemes, details of which are given on pages 94 to 97 in the directors' remuneration report. Further disclosures have not been included as they are considered immaterial to the assessment of the share-based payments charge.

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

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

Company

The company has no employees.

3 Operating profit

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

	2016 £m	Re-presented* 2015 £m
Other operating costs		
Hired and contracted services	**107.5**	93.4
Property rates	**86.3**	80.5
Materials	**67.2**	58.5
Power	**65.3**	69.1
Charge for bad and doubtful receivables (see note 14)	**39.2**	52.9
Regulatory fees	**27.9**	29.2
Third party wholesale charges	**15.1**	10.8
Impairment of property, plant and equipment (see note 9)	**11.4**	–
Cost of properties disposed	**10.5**	0.6
Legal and professional expenses	**5.8**	4.8
Loss on disposal of property, plant and equipment	**5.4**	5.1
Operating leases payable:		
Property	**4.2**	3.7
Plant and equipment	**0.8**	0.7
Impairment of assets classified as held for sale (see note 15)	**2.7**	–
Loss on disposal of intangible assets	**–**	0.5
Amortisation of deferred grants and contributions (see note 21)	**(6.9)**	(7.7)
Compensation from insurers	**(20.1)**	–
Other expenses	**63.5**	22.2
	485.8	424.3
Other income		
Other income	**(3.6)**	(3.3)
	(3.6)	(3.3)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 9)	**332.5**	323.6
Amortisation of intangible assets (see note 10)	**31.2**	29.0
	363.7	352.6

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

Notes to the financial statements

3 Operating profit continued

During the year, there were £19.5 million (2015: £nil) of expenses incurred as a result of two significant flooding incidents caused by storms Desmond and Eva (see page 6) comprising an £11.4 million impairment of property, plant and equipment, £7.0 million of operating costs and £1.1 million of infrastructure renewals expenditure. Insurance compensation of £20.1 million relating to the flooding incidents has been recognised to the extent that the group considers the recovery to be 'virtually certain' at 31 March 2016. The group expects there to be further substantial recovery of the flooding incident costs under its insurance cover in the year ending 31 March 2017, though at this stage it is not practicable to estimate the value of this.

In addition, there were £24.8 million (2015: £nil) of costs, largely comprising customer compensation payments included within other expenses, incurred in relation to a large water quality incident (see page 6) and £11.1 million (2015: £1.1 million) in relation to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

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

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

	2016 £'000	2015 £'000
Audit services		
Statutory audit – group and company	**70**	43
Statutory audit – subsidiaries	**239**	291
Regulatory reporting	**45**	30
	354	364
Audit-related services	**50**	30
Other non-audit services	**238**	250
	642	644

4 Investment income

	2016 £m	2015 £m
Interest receivable on short-term bank deposits held at amortised cost	**1.9**	1.0
Net pension interest income (see note 18)	**3.1**	–
	5.0	1.0

5 Finance expense

	2016 £m	2015 £m
Interest payable		
Interest payable on borrowings held at amortised cost[1]	198.1	206.1
	198.1	206.1
Fair value losses/(gains) on debt and derivative instruments[2]		
Fair value hedge relationships:		
Borrowings	60.8	112.8
Designated swaps	(62.2)	(122.7)
	(1.4)	(9.9)
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss[3]	4.3	65.0
Associated swaps[4]	(23.5)	(73.5)
	(19.2)	(8.5)
Fixed interest rate swaps[4]	46.2	133.5
Electricity swaps[4]	14.2	(6.0)
Net receipts on swaps and debt under fair value option	(16.1)	(2.5)
Other swaps[4][5]	(3.0)	1.1
Other	5.6	(3.0)
	46.9	123.1
Net fair value losses on debt and derivative instruments[6]	26.3	104.7
Net pension interest expense (see note 18)	–	7.0
	224.4	317.8

Notes:

(1) Includes a £37.9 million (2015: £46.6 million) non-cash inflation uplift expense in relation to the group's index-linked debt.
(2) Includes foreign exchange losses of £62.1 million (2015: £10.5 million gains), excluding those on instruments measured at fair value through profit or loss. These losses/gains are largely offset by fair value gains/losses on derivatives.
(3) Includes a £15.1 million gain (2015: £4.6 million loss) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.
(4) These swap contracts are not designated within an IAS 39 hedge relationship and are, as a result, classed as 'held for trading' under the accounting standard. These derivatives form economic hedges and, as such, management intend to hold these through to maturity.
(5) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.
(6) Includes £16.5 million income (2015: £4.0 million) due to net interest on swaps and debt under fair value option.

Interest payable is stated net of £21.3 million (2015: £20.9 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. This has been calculated by applying a capitalisation rate of 2.7 per cent (2015: 3.1 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

Notes to the financial statements

6 Tax

	2016 £m	2015 £m
Current tax		
UK corporation tax	**53.3**	56.8
Adjustments in respect of prior years	**(9.0)**	(9.7)
Total current tax charge for the year	**44.3**	47.1
Deferred tax		
Current year	**18.6**	14.3
Adjustments in respect of prior years	**5.6**	9.0
	24.2	23.3
Change in tax rate	**(112.5)**	–
Total deferred tax (credit)/charge for the year	**(88.3)**	23.3
Total tax (credit)/charge for the year	**(44.0)**	70.4

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

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

	2016 £m	2016 %	2015 £m	2015 %
Profit before tax	**353.5**		341.6	
Tax at the UK corporation tax rate	**70.7**	**20.0**	71.7	21.0
Adjustments in respect of prior years	**(3.4)**	**(1.0)**	(0.7)	(0.2)
Change in tax rate	**(112.5)**	**(31.8)**	–	–
Net income not taxable/other	**1.2**	**0.3**	(0.6)	(0.2)
Total tax (credit)/charge and effective tax rate for the year	**(44.0)**	**(12.5)**	70.4	20.6

Tax on items taken directly to equity

	2016 £m	2015 £m
Deferred tax (see note 19)		
On remeasurement gains on defined benefit pension schemes	**32.0**	50.1
Change in tax rate	**(5.5)**	–
	26.5	50.1
Total tax charge on items taken directly to equity	**26.5**	50.1

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

7 Earnings per share

	2016 £m	2015 £m
Profit after tax attributable to equity holders of the company	**397.5**	271.2

	2016 pence	2015 pence
Earnings per share		
Basic	**58.3**	39.8
Diluted	**58.2**	39.7

Basic earnings per share is calculated by dividing profit after tax for the financial year attributable to equity holders of the company by 681.9 million, being the weighted average number of shares in issue during the year (2015: 681.9 million). Diluted earnings per share is calculated by dividing profit after tax for the financial year attributable to equity holders of the company by 683.0 million, being the weighted average number of shares in issue during the year including dilutive shares (2015: 683.3 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'. Potential dilutive ordinary shares comprise outstanding share options awarded to directors and certain employees (see note 2).

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

	2016 million	2015 million
Average number of ordinary shares – basic	**681.9**	681.9
Effect of potential dilutive ordinary shares – share options	**1.1**	1.4
Average number of ordinary shares – diluted	**683.0**	683.3

8 Dividends

	2016 £m	2015 £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 2015 at 25.14 pence per share (2014: 24.03 pence)	**171.4**	163.8
Interim dividend for the year ended 31 March 2016 at 12.81 pence per share (2015: 12.56 pence)	**87.3**	85.6
	258.7	249.4
Proposed final dividend for the year ended 31 March 2016 at 25.64 pence per share (2015: 25.14 pence)	**174.8**	171.4

The proposed final dividends for the years ended 31 March 2016 and 31 March 2015 were subject to approval by equity holders of United Utilities Group PLC as at the reporting dates, and hence have not been included as liabilities in the consolidated financial statements at 31 March 2016 and 31 March 2015 respectively.

Notes to the financial statements

9 Property, plant and equipment

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

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

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

Company

The company had no property, plant and equipment or contractual commitments for the acquisition of property, plant and equipment at 31 March 2016 or 31 March 2015.

10 Intangible assets

	Total £m
Cost	
At 1 April 2014	229.8
Additions	64.2
Disposals	(29.5)
At 31 March 2015	**264.5**
Additions	**67.0**
Transfer to assets classified as held for sale (see note 15)	**(20.6)**
At 31 March 2016	**310.9**
Accumulated amortisation	
At 1 April 2014	119.6
Charge for the year	29.0
Disposals	(29.0)
At 31 March 2015	**119.6**
Charge for the year	**31.2**
Transfer to assets classified as held for sale (see note 15)	**(2.3)**
At 31 March 2016	**148.5**
Net book value at 31 March 2015	144.9
Net book value at 31 March 2016	**162.4**

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

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

Company

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

11 Joint ventures

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

The joint ventures have no significant contingent liabilities to which the group is exposed. The group has issued guarantees of £4.7 million in support of its joint ventures (2015: £4.7 million) which are included in the contingent liabilities total disclosed in note 24.

Notes to the financial statements

12 Investments

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

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

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

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

Company	Shares in subsidiary undertakings £m
Cost	
At 31 March 2016, 31 March 2015 and 1 April 2014	6,326.8
Impairment	
At 1 April 2014	726.8
Reversal	(726.8)
At 31 March 2016 and 31 March 2015	–
Net book value at 31 March 2016 and 31 March 2015	**6,326.8**

In the year ended 31 March 2016, a review has been performed supporting the carrying value of the £6,326.8 million investment in United Utilities PLC.

During the year ended 31 March 2015, the review resulted in the reversal of an impairment made during the year ended 31 March 2010. The reviews are based on a 'fair value less costs of disposal' valuation.

13 Inventories

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

Company

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

14 Trade and other receivables

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Trade receivables	**175.1**	176.6	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**62.5**	61.2
Amounts owed by related parties (see note A6)	**2.9**	2.8	**–**	–
Other debtors	**54.4**	22.6	**–**	–
Prepayments and accrued income	**137.5**	153.8	**–**	–
	369.9	355.8	**62.5**	61.2

At 31 March 2016, the group had £2.5 million (2015: £2.5 million) of trade and other receivables classified as non-current.

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

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

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

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

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

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

Trade receivables	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2016	**127.0**	**37.5**	**5.1**	**169.6**
At 31 March 2015	125.8	43.6	3.2	172.6

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

Company

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

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

Notes to the financial statements

15 Assets classified as held for sale

During the year, the group entered into an agreement which will involve the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, into a new joint venture with Severn Trent PLC. As at 31 March 2016, completion of the disposal was expected within 12 months, subject to clearance from the Competition and Markets Authority, and so £18.3 million of intangible assets have been classified as held for sale. These assets have subsequently been impaired by £2.7 million during the year to give a carrying value of £15.6 million, which ensures that the assets are valued at fair value less cost to sell in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'. See note 25 for events occurring after 31 March 2016.

16 Cash and cash equivalents

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Cash at bank and in hand	**4.8**	4.5	**–**	–
Short-term bank deposits	**208.8**	239.5	**–**	–
Cash and short-term deposits	**213.6**	244.0	**–**	–
Book overdrafts (included in borrowings, see note 17)	**(31.5)**	(24.3)	**(0.5)**	(0.4)
Cash and cash equivalents in the statement of cash flows	**182.1**	219.7	**(0.5)**	(0.4)

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. The carrying amounts of cash and cash equivalents approximate their fair value.

Book overdrafts, which result from cash management practices, represent the value of cheques issued that had not cleared as at the balance sheet date.

17 Borrowings

Group	**2016 £m**	2015 £m
Non-current liabilities		
Bonds	**4,439.2**	4,239.6
Bank and other term borrowings	**2,069.6**	1,827.7
	6,508.8	6,067.3
Current liabilities		
Bonds	**–**	425.9
Bank and other term borrowings	**437.7**	127.9
Book overdrafts (see note 16)	**31.5**	24.3
	469.2	578.1
	6,978.0	6,645.4

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

17 Borrowings continued

Company	2016 £m	2015 £m
Non-current liabilities		
Amounts owed to subsidiary undertakings	**1,636.9**	1,609.4
	1,636.9	1,609.4
Current liabilities		
Book overdrafts (see note 16)	**0.5**	0.4
	0.5	0.4
	1,637.4	1,609.8

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

18 Retirement benefit surplus

Defined benefit schemes

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

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

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £25.0 million (2015: £20.7 million) comprising current service costs and administrative expenses. Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £34.9 million (2015: £29.5 million) comprise the defined benefit costs described above of £25.0 million (2015: £20.7 million) and defined contribution pension costs of £9.9 million (2015: £8.8 million) (see note 2).

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

Group	2016 £m	2015 £m
At the start of the year	**79.2**	(177.4)
Expense recognised in the income statement	**(23.0)**	(33.2)
Contributions paid	**58.9**	39.3
Remeasurement gains gross of tax	**160.1**	250.5
At the end of the year	**275.2**	79.2

Notes to the financial statements

18 Retirement benefit surplus continued

Included in the contributions paid of £58.9 million (2015: £39.3 million) were deficit repair contributions of £33.3 million (2015: £9.7 million). No inflation funding mechanism payments were made during the year (2015: £5.5 million).

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

	2016 £m	2015 £m
The return on plan assets, excluding amounts included in interest	**56.0**	705.2
Actuarial gains/(losses) arising from changes in financial assumptions	**98.1**	(500.8)
Actuarial (losses)/gains arising from changes in demographic assumptions	**(46.6)**	10.2
Actuarial gains arising from experience	**52.6**	35.9
Remeasurement gains on defined benefit pension schemes	**160.1**	250.5

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

Defined contribution schemes

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

Company

The company did not participate in any of the group's pension schemes during the years ended 31 March 2016 and 31 March 2015.

19 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 tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2014	1,084.0	(35.5)	1.9	1,050.4
Charged/(credited) to the income statement	41.0	2.0	(19.7)	23.3
Charged to equity (see note 6)	–	50.1	–	50.1
At 31 March 2015	**1,125.0**	**16.6**	**(17.8)**	**1,123.8**
(Credited)/charged to the income statement	**(88.2)**	**6.5**	**(6.6)**	**(88.3)**
Charged to equity (see note 6)	**–**	**26.5**	**–**	**26.5**
At 31 March 2016	**1,036.8**	**49.6**	**(24.4)**	**1,062.0**

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

Company

The company had no deferred tax assets or liabilities at 31 March 2016 or 31 March 2015.

20 Provisions

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

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

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

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

Company

The company had no provisions at 31 March 2016 or 31 March 2015.

21 Trade and other payables

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

		Group		Company
Current	**2016 £m**	2015 £m	**2016 £m**	2015 £m
Trade payables	**44.1**	40.1	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**9.5**	9.2
Other tax and social security	**4.9**	4.7	**–**	–
Deferred grants and contributions	**9.0**	9.1	**–**	–
Other creditors	**3.4**	3.7	**1.6**	1.6
Accruals and deferred income	**280.3**	323.6	**–**	–
	341.7	381.2	**11.1**	10.8

The average credit period taken for trade purchases is 26 days (2015: 28 days).

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

Notes to the financial statements

21 Trade and other payables continued

Deferred grants and contributions

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

22 Share capital

Group and company	2016 million	2016 £m	2015 million	2015 £m
Issued, called up and fully paid				
Ordinary shares of 5.0 pence each	**681.9**	**34.1**	681.9	34.1
Deferred shares of 170.0 pence each	**274.0**	**465.7**	274.0	465.7
	955.9	**499.8**	955.9	499.8

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

23 Operating lease commitments

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

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

The company had no operating lease commitments at 31 March 2016 or 31 March 2015.

24 Contingent liabilities

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

The company has not entered into performance guarantees as at 31 March 2016 or 31 March 2015.

25 Events after the reporting period

On 3 May 2016, the Competition and Markets Authority approved the joint venture arrangement with Severn Trent PLC detailed in note 15 and, as a result, completion is expected to occur in June 2016.

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

Notes to the financial statements – appendices

A1 Cash generated from operations

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Profit before tax	**353.5**	341.6	**230.8**	950.0
Adjustment for investment income (see note 4) and finance expense (see note 5)	**219.4**	316.8	**27.9**	26.3
Adjustment for share of profits of joint ventures	**(5.0)**	(5.1)	**–**	–
Operating profit	**567.9**	653.3	**258.7**	976.3
Adjustments for:				
Depreciation of property, plant and equipment (see note 9)	**332.5**	323.6	**–**	–
Amortisation of intangible assets (see note 10)	**31.2**	29.0	**–**	–
Impairment of property, plant and equipment (see note 9)	**11.4**	–	**–**	–
Impairment of assets classified as available for sale (see note 15)	**2.7**	–	**–**	–
Loss on disposal of property, plant and equipment (see note 3)	**5.4**	5.1	**–**	–
Loss on disposal of intangible assets (see note 3)	**–**	0.5	**–**	–
Amortisation of deferred grants and contributions (see note 21)	**(6.9)**	(7.7)	**–**	–
Equity-settled share-based payments charge (see note 2)	**2.3**	2.9	**–**	–
Other non-cash movements*	**(3.8)**	(1.2)	**–**	(726.8)
Changes in working capital:				
Decrease/(increase) in inventories	**11.2**	(0.7)	**–**	–
(Increase)/decrease in trade and other receivables	**(14.1)**	(23.0)	**2.6**	6.5
(Decrease)/increase in trade and other payables	**(4.1)**	(23.2)	**–**	0.1
Increase/(decrease) in provisions (see note 20)	**2.6**	(3.8)	**–**	–
Pension contributions paid less pension expense charged to operating profit	**(32.8)**	(13.1)	**–**	–
Cash generated from operations	**905.5**	941.7	**261.3**	256.1

* Material non-cash transactions during the prior year include, for the company, the reversal of a past impairment made against the company's investment in its subsidiary, United Utilities PLC (see note 12).

The group has received property, plant and equipment of £32.8 million (2015: £27.0 million) in exchange for the provision of future goods and services (see notes 21 and A7).

A2 Net debt

Group	**2016 £m**	2015 £m
At the start of the year	**5,924.0**	5,515.9
Net capital expenditure	**681.6**	709.0
Dividends (see note 8)	**258.7**	249.4
Interest	**166.8**	174.6
Tax	**53.1**	60.6
Fair value movements*	**42.4**	107.2
Inflation uplift on index-linked debt (see note 5)	**37.9**	46.6
Other	**1.5**	2.4
Cash generated from operations (see note A1)	**(905.5)**	(941.7)
At the end of the year	**6,260.5**	5,924.0

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

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

Notes to the financial statements – appendices

A3 Borrowings

Terms and debt repayment schedule

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

	Currency	Year of final repayment	Fair value 2016 £m	Carrying value 2016 £m	Fair value 2015 £m	Carrying value 2015 £m
Borrowings in fair value hedge relationships			**2,293.0**	**2,373.0**	2,218.0	2,252.1
5.375% 150m bond	GBP	2018	**169.6**	**162.5**	175.1	167.0
4.55% 250m bond	USD	2018	**183.9**	**185.6**	181.3	183.0
5.375% 350m bond	USD	2019	**263.2**	**269.3**	259.1	265.8
4.25% 500m bond	EUR	2020	**455.9**	**455.1**	427.5	424.1
5.75% 375m bond	GBP	2022	**449.5**	**434.5**	457.9	432.4
1.129% 52m bond	EUR	2027	**38.4**	**41.0**	–	–
5.625% 300m bond	GBP	2027	**382.7**	**411.1**	391.2	408.1
5.02% JPY 10bn dual currency loan	JPY/USD	2029	**81.4**	**96.1**	75.4	86.3
2.058% 30m bond	EUR	2030	**23.7**	**25.1**	–	–
5% 200m bond	GBP	2035	**244.7**	**292.7**	250.5	285.4
Borrowings designated at fair value through profit or loss			**338.0**	**338.0**	333.7	333.7
6.875% 400m bond	USD	2028	**338.0**	**338.0**	333.7	333.7
Borrowings measured at amortised cost			**4,830.1**	**4,267.0**	4,798.5	4,059.6
6.125% 425m bond	GBP	2015	**–**	**–**	447.6	425.9
Short-term bank borrowings – fixed	GBP	2016	**127.5**	**127.5**	117.5	117.5
1.97%+RPI 200m IL loan	GBP	2016	**269.9**	**267.4**	271.9	264.1
1.30%+LIBOR 5bn bond	JPY	2017	**31.7**	**32.0**	29.2	28.8
2.46%+RPI 50m IL loan	GBP	2020	**65.7**	**59.3**	67.0	58.5
2.10%+RPI 50m IL loan	GBP	2020	**64.7**	**59.3**	65.8	58.5
1.93%+RPI 50m IL loan	GBP	2020	**64.5**	**59.4**	65.5	58.6
1.90%+RPI 50m IL loan	GBP	2020	**64.5**	**59.5**	65.5	58.7
1.88%+RPI 50m IL loan	GBP	2020	**64.2**	**59.3**	65.2	58.6
1.84%+RPI 50m IL loan	GBP	2020	**64.4**	**59.6**	65.3	58.8
1.73%+RPI 50m IL loan	GBP	2020	**64.2**	**59.6**	65.1	58.8
1.61%+RPI 50m IL loan	GBP	2020	**63.9**	**59.7**	64.8	58.9
0.80%+LIBOR 100m loan	GBP	2022	**98.3**	**100.0**	–	–
0.47%+RPI 100m IL loan	GBP	2023	**105.0**	**105.2**	105.0	103.8
0.49%+RPI 100m IL loan	GBP	2025	**101.1**	**101.2**	101.6	99.9
0.013%+RPI 25m IL bond	GBP	2025	**24.2**	**25.2**	–	–
0.1275%+RPI 100m IL loan	GBP	2026	**96.4**	**100.0**	–	–
1.29%+RPI 50m (amortising) IL loan	GBP	2029	**58.6**	**54.2**	59.3	55.4
1.23%+RPI 50m (amortising) IL loan	GBP	2029	**54.6**	**52.5**	59.1	55.8
1.12%+RPI 50m (amortising) IL loan	GBP	2029	**57.6**	**53.7**	58.2	55.0
1.10%+RPI 50m (amortising) IL loan	GBP	2029	**57.4**	**53.7**	58.0	54.9
0.75%+RPI 50m (amortising) IL loan	GBP	2029	**55.2**	**54.4**	55.6	53.7
0.76%+RPI 50m (amortising) IL loan	GBP	2030	**55.0**	**54.3**	55.4	53.6
1.15%+RPI 50m (amortising) IL loan	GBP	2030	**56.2**	**54.1**	56.8	53.4

A3 Borrowings continued

	Currency	Year of final repayment	Fair value 2016 £m	Carrying value 2016 £m	Fair value 2015 £m	Carrying value 2015 £m
Borrowings measured at amortised cost continued						
1.11%+RPI 50m (amortising) IL loan	GBP	2030	56.2	54.2	56.8	53.5
0.178%+RPI 35m IL bond	GBP	2030	33.6	35.3	–	–
0.709%+LIBOR 100m (amortising) loan	GBP	2032	95.6	100.0	97.7	100.0
0.691%+LIBOR 150m (amortising) loan	GBP	2032	142.9	150.0	146.2	150.0
3.375%+RPI 50m IL bond	GBP	2032	107.6	72.8	110.9	72.0
0.573%+LIBOR 100m (amortising) loan	GBP	2033	93.7	100.0	96.1	100.0
0.511%+LIBOR 150m (amortising) loan	GBP	2033	140.0	150.0	–	–
0.01%+RPI 100m (amortising) IL loan	GBP	2033	94.7	99.7	–	–
0.01%+RPI 75m (amortising) IL loan	GBP	2034	71.1	74.7	–	–
1.9799%+RPI 100m IL bond	GBP	2035	171.4	136.4	174.9	135.0
1.66%+RPI 35m IL bond	GBP	2037	51.6	43.6	52.9	43.0
2.40%+RPI 70m IL bond	GBP	2039	113.5	85.0	117.2	83.8
1.7829%+RPI 100m IL bond	GBP	2040	172.8	135.0	177.4	133.6
1.3258%+RPI 50m IL bond	GBP	2041	78.9	67.3	80.7	66.7
1.5802%+RPI 100m IL bond	GBP	2042	166.6	134.5	171.7	133.2
1.5366%+RPI 50m IL bond	GBP	2043	82.5	67.1	85.0	66.5
1.397%+RPI 50m IL bond	GBP	2046	81.8	67.3	85.0	66.6
1.7937%+RPI 50m IL bond	GBP	2049	91.1	67.0	95.0	66.3
Commission for New Towns (amortising) loan – fixed	GBP	2053	52.5	28.7	55.6	29.3
1.847%+RPI 100m IL bond	GBP	2056	180.8	131.6	186.8	129.9
1.815%+RPI 100m IL bond	GBP	2056	179.4	131.0	185.5	129.3
1.662%+RPI 100m IL bond	GBP	2056	173.1	130.8	178.8	129.1
1.591%+RPI 25m IL bond	GBP	2056	42.4	32.6	43.6	32.2
1.5865%+RPI 50m IL bond	GBP	2056	85.6	65.3	86.9	64.5
1.556%+RPI 50m IL bond	GBP	2056	84.5	65.0	86.9	64.2
1.435%+RPI 50m IL bond	GBP	2056	82.0	64.8	84.2	63.9
1.3805%+RPI 35m IL bond	GBP	2056	56.7	45.3	58.2	44.7
1.702%+RPI 50m IL bond	GBP	2057	86.1	63.5	88.7	62.6
1.585%+RPI 100m IL bond	GBP	2057	165.1	125.9	172.1	124.2
Book overdrafts (see note 16)	GBP	2016	31.5	31.5	24.3	24.3
			7,461.1	6,978.0	7,350.2	6,645.4

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

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

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

Notes to the financial statements – appendices

A4 Financial risk management

Risk management

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

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

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

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

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

Liquidity risk

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

At 31 March 2016, the group had £888.6 million (2015: £1,244.0 million) of available liquidity, which comprised £213.6 million (2015: £244.0 million) of cash and short-term deposits, £600.0 million (2015: £600.0 million) of undrawn committed borrowing facilities, and £75.0 million (2015: £400.0 million) of undrawn term loan facilities. Short-term deposits mature within three months.

The group had available committed borrowing facilities as follows:

Group	2016 £m	2015 £m
Expiring within one year	**150.0**	50.0
Expiring after one year but in less than two years	**150.0**	150.0
Expiring after more than two years	**300.0**	400.0
Undrawn borrowing facilities	**600.0**	600.0

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

Company

The company did not have any committed facilities available at 31 March 2016 or 31 March 2015.

A4 Financial risk management continued

Maturity analysis

Concentrations of risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the group'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 2016**	**Total[1] £m**	**Adjust-ment[2] £m**	**1 year or less £m**	**1–2 years £m**	**2–3 years £m**	**3–4 years £m**	**4–5 years £m**	**More than 5 years £m**
Bonds	**9,620.9**		**146.4**	**178.9**	**707.4**	**535.9**	**103.7**	**7,948.6**
Bank and other term borrowings	**3,148.8**		**505.8**	**89.8**	**107.4**	**109.7**	**656.9**	**1,679.2**
Adjustment to carrying value[2]	**(5,791.7)**	**(5,791.7)**						
Borrowings	**6,978.0**	**(5,791.7)**	**652.2**	**268.7**	**814.8**	**645.6**	**760.6**	**9,627.8**
Derivatives:								
Payable	**1,154.6**		**94.7**	**117.1**	**393.2**	**411.1**	**26.4**	**112.1**
Receivable	**(1,671.3)**		**(128.1)**	**(196.2)**	**(700.0)**	**(485.4)**	**(8.0)**	**(153.6)**
Adjustment to carrying value[2]	**12.8**	**12.8**						
Derivatives – net assets	**(503.9)**	**12.8**	**(33.4)**	**(79.1)**	**(306.8)**	**(74.3)**	**18.4**	**(41.5)**

At 31 March 2015	Total[1] £m	Adjust-ment[2] £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Bonds	10,067.1		593.3	143.4	173.3	691.1	502.8	7,963.2
Bank and other term borrowings	2,536.9		184.5	348.9	84.2	85.8	86.9	1,746.6
Adjustment to carrying value[2]	(5,958.6)	(5,958.6)						
Borrowings	6,645.4	(5,958.6)	777.8	492.3	257.5	776.9	589.7	9,709.8
Derivatives:								
Payable	1,039.6		89.3	70.7	101.3	369.9	383.0	25.4
Receivable	(1,534.2)		(124.2)	(101.4)	(176.9)	(626.9)	(502.3)	(2.5)
Adjustment to carrying value[2]	17.2	17.2						
Derivatives – net assets	(477.4)	17.2	(34.9)	(30.7)	(75.6)	(257.0)	(119.3)	22.9

Notes:

(1) Forecast future cash flows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are therefore susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be three per cent over the life of each instrument.

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

Company

The company has total borrowings of £0.5 million (2015: £0.4 million), which are payable within one year, and £1,636.9 million (2015: £1,609.4 million), which are payable within one to two years.

Notes to the financial statements – appendices

A4 Financial risk management continued

Credit risk

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

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. In addition, under the group's revenue recognition policy, revenue is only recognised when collection of the resulting receivable is reasonably assured. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 14).

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

At 31 March 2016 and 31 March 2015, the maximum exposure to credit risk for the group and company is represented by the carrying amount of each financial asset in the statement of financial position:

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Cash and short-term deposits (see note 16)	**213.6**	244.0	**–**	–
Trade and other receivables (see note 14)	**369.9**	355.8	**62.5**	61.2
Investments (see note 12)	**8.7**	8.6	**–**	–
Derivative financial instruments	**765.6**	682.6	**–**	–
	1,357.8	1,291.0	**62.5**	61.2

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2016, the group held £127.5 million (2015: £117.5 million) as collateral in relation to derivative financial instruments (included within borrowings in note A3).

A4 Financial risk management continued

Market risk

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

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

Inflation risk

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

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

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

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

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

Sensitivity analysis

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

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

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

Company

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

Notes to the financial statements – appendices

A4 Financial risk management continued

Interest rate risk

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

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

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

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

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

Sensitivity analysis

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

	Group		Company	
Increase/(decrease) in profit before tax and equity	**2016 £m**	2015 £m	**2016 £m**	2015 £m
1 per cent increase in interest rate	**175.6**	174.2	**(16.4)**	(16.1)
1 per cent decrease in interest rate	**(183.0)**	(190.9)	**16.4**	16.1

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

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

A4 Financial risk management continued

Repricing analysis

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

Group **At 31 March 2016**	**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	**2,373.0**	**–**	**–**	**617.4**	**455.1**	**–**	**1,300.5**
Effect of swaps	**–**	**2,373.0**	**–**	**(617.4)**	**(455.1)**	**–**	**(1,300.5)**
	2,373.0	**2,373.0**	**–**	**–**	**–**	**–**	**–**
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	**338.0**	**–**	**–**	**–**	**–**	**–**	**338.0**
Effect of swaps	**–**	**338.0**	**–**	**–**	**–**	**–**	**(338.0)**
	338.0	**338.0**	**–**	**–**	**–**	**–**	**–**
Borrowings measured at amortised cost							
Fixed rate instruments	**156.2**	**127.7**	**0.5**	**0.5**	**0.6**	**0.6**	**26.3**
Floating rate instruments	**663.5**	**663.5**	**–**	**–**	**–**	**–**	**–**
Index-linked instruments	**3,447.3**	**3,447.3**	**–**	**–**	**–**	**–**	**–**
	4,267.0	**4,238.5**	**0.5**	**0.5**	**0.6**	**0.6**	**26.3**
Effect of fixed interest rate swaps	**–**	**(3,006.3)**	**(125.0)**	**(50.0)**	**1,127.1**	**325.0**	**1,729.2**
Total borrowings	**6,978.0**	**3,943.2**	**(124.5)**	**(49.5)**	**1,127.7**	**325.6**	**1,755.5**
Cash and short-term deposits	**(213.6)**	**(213.6)**	**–**	**–**	**–**	**–**	**–**
Net borrowings	**6,764.4**	**3,729.6**	**(124.5)**	**(49.5)**	**1,127.7**	**325.6**	**1,755.5**

At 31 March 2015	Total £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,252.1	–	–	–	615.8	424.1	1,212.2
Effect of swaps	–	2,252.1	–	–	(615.8)	(424.1)	(1,212.2)
	2,252.1	2,252.1	–	–	–	–	–
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	333.7	–	–	–	–	–	333.7
Effect of swaps	–	333.7	–	–	–	–	(333.7)
	333.7	333.7	–	–	–	–	–
Borrowings measured at amortised cost							
Fixed rate instruments	572.7	543.8	0.4	0.5	0.5	0.6	26.9
Floating rate instruments	403.1	403.1	–	–	–	–	–
Index-linked instruments	3,083.8	3,083.8	–	–	–	–	–
	4,059.6	4,030.7	0.4	0.5	0.5	0.6	26.9
Effect of fixed interest rate swaps	–	(2,656.3)	(250.0)	(125.0)	(50.0)	1,127.1	1,954.2
Total borrowings	6,645.4	3,960.2	(249.6)	(124.5)	(49.5)	1,127.7	1,981.1
Cash and short-term deposits	(244.0)	(244.0)	–	–	–	–	–
Net borrowings	6,401.4	3,716.2	(249.6)	(124.5)	(49.5)	1,127.7	1,981.1

Notes to the financial statements – appendices

A4 Financial risk management continued

Company	2016 Total £m	2016 1 year or less £m	2015 Total £m	2015 1 year or less £m
Borrowings measured at amortised cost				
Floating rate instruments	**1,637.4**	**1,637.4**	1,609.8	1,609.8
Total borrowings	**1,637.4**	**1,637.4**	1,609.8	1,609.8

Electricity price risk

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

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

Sensitivity analysis

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

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

The company has no exposure to electricity price risk.

Currency risk

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

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

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

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

Capital risk management

The group's objective when managing capital is to maintain efficient access to debt capital markets throughout the economic cycle. The board therefore believes that it is appropriate to maintain gearing, measured as group consolidated net debt (including derivatives) to regulatory capital value (RCV) of United Utilities Water Limited (UUW), within a target range of 55 per cent to 65 per cent. As at 31 March 2016, group consolidated gearing was 61 per cent (2015: 59 per cent), which is comfortably within this range.

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

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

A4 Financial risk management continued

Fair values

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

Group 2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	–	8.7	–	8.7
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	–	583.8	–	583.8
Derivative financial assets – held for trading[(1)]	–	181.8	–	181.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[(1)]	–	(261.7)	–	(261.7)
Financial liabilities designated as fair value through profit or loss	–	(338.0)	–	(338.0)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,149.5)	(143.5)	–	(2,293.0)
Other financial liabilities at amortised cost	(1,309.9)	(3,520.2)	–	(4,830.1)
	(3,459.4)	(3,489.1)	–	(6,948.5)

2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	–	8.6	–	8.6
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	–	521.6	–	521.6
Derivative financial assets – held for trading[(1)]	–	161.0	–	161.0
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[(1)]	–	(205.2)	–	(205.2)
Financial liabilities designated as fair value through profit or loss	–	(333.7)	–	(333.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,142.6)	(75.4)	–	(2,218.0)
Other financial liabilities at amortised cost	(2,530.3)	(2,268.2)	–	(4,798.5)
	(4,672.9)	(2,191.3)	–	(6,864.2)

Note:

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

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

The group has calculated fair values using quoted prices where an active market exists, which has resulted in £3,459.4 million (2015: £4,672.9 million) of 'level 1' fair value measurements. In the absence of an appropriate quoted price, the group has applied discounted cash flow valuation models utilising market available data in line with prior years. The £1,213.5 million reduction (2015: £1,493.9 million increase) in 'level 1' fair value measurements is largely due to the maturity of a £425.0 million bond during the year and a decrease in the number of observable quoted bond prices at 31 March 2016.

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

Notes to the financial statements – appendices

A4 Financial risk management continued

Company

The company does not hold any financial instruments that are measured subsequent to initial recognition at fair value or where fair value has been separately disclosed in the notes as the carrying value is not a reasonable approximation of fair value.

A5 Retirement benefits

Defined benefit schemes

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

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

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

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

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

The defined benefit obligation includes benefits for current employees, former employees and current pensioners as analysed in the table below:

Group	2016 £m	2015 £m
Total value of current employees benefits	**831.6**	839.9
Deferred members benefits	**624.1**	666.5
Pensioner members benefits	**1,514.7**	1,548.1
Total defined benefit obligation	**2,970.4**	3,054.5

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

Funding requirements

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

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

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

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

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

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

A5 Retirement benefits continued

Impact of scheme risk management on IAS 19 disclosures

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

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

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

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

In the year ended 31 March 2016, the discount rate has increased by 0.3 per cent, which includes a 0.7 per cent increase in credit spreads offset by a decrease in swap yields over the year. The IAS 19 remeasurement gain of £160.1 million reported in note 18 has largely resulted from the impact of the increase in credit spreads during the year, partially offset by the impact of a 0.2 per cent increase in inflation.

Reporting and assumptions

The results of the latest funding valuations at 31 March 2013 have been adjusted to take account of the requirements of IAS 19 in order to assess the position at 31 March 2016, by taking account of experience over the period, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service costs, were measured using the projected unit credit method.

Financial assumptions

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

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

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

Notes to the financial statements – appendices

A5 Retirement benefits continued

Demographic assumptions

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

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

Sensitivity of the key scheme assumptions

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

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

– Discount rate
An increase/decrease in the discount rate of 0.1 per cent would have resulted in a £58.4 million (2015: £60.1 million) decrease/increase in the schemes' liabilities at 31 March 2016, although as long as credit spreads remain stable this will be largely offset by an increase in the value of the schemes' bond holdings and other instruments designed to hedge this exposure. The discount rate is based on AA 'corporate bond' yields of a similar duration to the schemes' liabilities.

– Price inflation
An increase/decrease in the inflation assumption of 0.1 per cent would have resulted in a £55.3 million (2015: £56.6 million) increase/decrease in the schemes' liabilities at 31 March 2016, as a significant proportion of the schemes' benefit obligations are linked to inflation. In some cases, caps on the level of inflationary increases are in place to protect against extreme inflation. The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit. Any change in inflation out-turn results in a change to the cash contributions provided under the IFM.

– Life expectancy
An increase/decrease in the mortality long-term annual rate of improvement of 0.25 per cent would have resulted in a £45.4 million (2015: £36.7 million) increase/decrease in the schemes' liabilities at 31 March 2016. The majority of the schemes' obligations are to provide benefits for the life of the member and, as such, the schemes' liabilities are sensitive to these assumptions.

A5 Retirement benefits continued

Further reporting analysis

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

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

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

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

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

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

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

Group	2016 £m	2015 £m
At the start of the year	**3,133.7**	2,377.0
Interest income on schemes' assets	**96.3**	101.0
The return on plan assets, excluding amounts included in interest	**56.0**	705.2
Member contributions	**5.8**	6.3
Benefits paid	**(102.4)**	(92.5)
Administrative expenses	**(2.7)**	(2.6)
Company contributions	**58.9**	39.3
At the end of the year	**3,245.6**	3,133.7

The group's actual return on the schemes' assets was a gain of £152.3 million (2015: £806.2 million), principally due to gains on derivatives hedging the schemes' liabilities.

Notes to the financial statements – appendices

A5 Retirement benefits continued

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

Group	2016 £m	2015 £m
At the start of the year	**(3,054.5)**	(2,554.4)
Interest cost on schemes' obligations	**(93.2)**	(108.0)
Actuarial gains/(losses) arising from changes in financial assumptions	**98.1**	(500.8)
Actuarial (losses)/gains arising from changes in demographic assumptions	**(46.6)**	10.2
Actuarial gains arising from experience	**52.6**	35.9
Curtailments/settlements	**(1.1)**	(5.5)
Member contributions	**(5.8)**	(6.3)
Benefits paid	**102.4**	92.5
Current service cost	**(22.3)**	(18.1)
At the end of the year	**(2,970.4)**	(3,054.5)

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

A6 Related party transactions

Group

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Trading transactions

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

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

In addition, the group has issued guarantees of £4.7 million (2015: £4.7 million) in support of its joint ventures (see note 11).

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

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 £258.7 million (2015: £249.5 million) and total net interest payable during the year was £27.9 million (2015: £26.3 million). Amounts outstanding at 31 March 2016 and 31 March 2015 between the parent company and subsidiary undertakings are provided in notes 14, 17 and 21.

At 31 March 2016 and 31 March 2015, 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 2016 and 31 March 2015.

A7 Accounting policies

Of the accounting policies outlined below, those deemed to be the most significant for the group are those that align with the critical accounting judgements and key sources of estimation uncertainty set out on pages 122 to 123.

Basis of consolidation

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

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

Subsidiaries

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

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

Joint ventures

Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture results and assets and liabilities is incorporated using the equity method of accounting. Under the equity method, an investment in a joint venture is initially recognised at cost and adjusted thereafter to recognise the group's share of the profit or loss.

Revenue recognition

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

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

Operating profit

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

Borrowing costs and finance income

Except as noted below, all borrowing costs and finance income are recognised in the income statement on an accruals basis.

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

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

Tax

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

Current tax

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

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

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

Deferred tax

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

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

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

Notes to the financial statements – appendices

A7 Accounting policies continued

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

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

Property, plant and equipment

Property, plant and equipment comprises water and wastewater infrastructure assets and overground assets.

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

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

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

Water and wastewater infrastructure assets

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

Other assets

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

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

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

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

Transfer of assets from customers and developers

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

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

Intangible assets

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

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

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

Impairment of tangible and intangible assets

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

A7 Accounting policies continued

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

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

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

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Financial instruments

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

Cash and short-term deposits

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

Financial investments

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

Trade receivables

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

Trade payables

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

Financial liabilities and equity

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

Equity instruments

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

Borrowings

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

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

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

Borrowings designated within a fair value hedge relationship

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

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

Notes to the financial statements – appendices

A7 Accounting policies continued

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

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

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

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

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

Inventories
Inventories are stated at the lower of cost and net realisable value. For properties held for resale, cost includes the cost of acquiring and developing the sites, including borrowing costs where applicable.

Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

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

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

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

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

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

Share-based compensation arrangements
The group operates equity-settled, share-based compensation plans, issued to certain employees. The 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 simulation models, according to the relevant measures of performance. The group has the option to settle some of these equity-settled share-based payments 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.

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

Foreign currency translation
Transactions and balances
Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period.

A7 Accounting policies continued

Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity. In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note A4).

Group companies

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

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

Grants and contributions

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

Leases

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

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

Notes to the financial statements – appendices

A8 Subsidiaries and other group undertakings

Details of the group's subsidiary undertakings, joint ventures and associates are set out below. Unless otherwise specified, the registered address for each entity is Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington WA5 3LP, United Kingdom. For further details of joint ventures and associates please see notes 11 and 12.

	Class of share capital held	Proportion of share capital owned/voting rights %*	Nature of business
Subsidiary undertakings			
Great Britain			
Halkyn District Mines Drainage Company Limited	Ordinary	99.9	Dormant
North West Water International Limited	Ordinary	100.0	Holding company for international business
North West Water Limited	Ordinary	100.0	Dormant
United Utilities (Overseas Holdings) Limited	Ordinary	100.0	Holding company
United Utilities Energy Limited	Ordinary	100.0	Energy generation
United Utilities Healthcare Trustee Limited	Ordinary	100.0	Corporate trustee
United Utilities International Limited	Ordinary	100.0	Consulting services and project management
United Utilities North West Limited	Ordinary	100.0	Holding company
United Utilities Operational Services Limited	Ordinary	100.0	Operations and maintenance contract holder
United Utilities Pensions Trustees Limited	Ordinary	100.0	Corporate trustee
United Utilities PLC	Ordinary	100.0	Holding and management company
United Utilities Property Services Limited	Ordinary	100.0	Property management
United Utilities Renewable Energy Limited	Ordinary	100.0	Renewable energy generation
United Utilities Total Solutions Limited	Ordinary	100.0	Water and wastewater services
United Utilities Utility Solution (Industrial) Limited	Ordinary	100.0	Holding company
United Utilities Utility Solution Holdings Limited	Ordinary	100.0	Holding company
United Utilities Water Finance PLC	Ordinary	100.0	Financing company
United Utilities Water Limited	Ordinary	100.0	Water and wastewater services
United Utilities Water Operations Holdings Limited	Ordinary	100.0	Holding company
United Utilities Water Sales Limited	Ordinary	100.0	Water and wastewater retail services
UU (ESPS) Pension Trustee Limited	Ordinary	100.0	Corporate trustee
UU Group Limited	Ordinary	100.0	Dormant
UU Secretariat Limited	Ordinary	100.0	Dormant
YCL Transport Limited	Ordinary	100.0	Non-trading
The Netherlands			
United Utilities (Tallinn) BV	Ordinary	100.0	Holding company
United Utilities BV	Ordinary	100.0	Holding company
United Utilities Europe Holdings BV	Ordinary	100.0	Holding company
Thailand			
Manta Management Services Limited[(1)]	Ordinary	49.0	Management company
Water Resources Limited[(1)]	Ordinary	100.0	Non-trading
Joint ventures			
Great Britain			
Lingley Mere Business Park Development Company Limited	Ordinary	50.0	Development company
Lingley Mere Management Company Limited	Ordinary	50.0	Property management
Selectusonline Limited	Ordinary	16.7	Procurement portal
Estonia			
AS Tallinna Vesi[(2)]	Ordinary	35.3	Water and wastewater services

A8 Subsidiaries and other group undertakings continued

	Class of share capital held	Proportion of share capital owned/voting rights %*	Nature of business
Associated undertakings			
Bahrain			
Muharraq STP Company BSC(c)[(3)]	Ordinary	20.0	Project company
Muharraq Wastewater Services Company WLL[(3)]	Ordinary	35.0	Operations and maintenance company
Jebel Ali Free Zone, Dubai, UAE			
Muharraq Holding Company 1 Limited[(4)]	Ordinary	20.0	Holding company
Muharraq Holding Company 2 Limited[(4)]	Ordinary	20.0	Holding company

* With the exception of United Utilities PLC, shares are held by subsidiary undertakings rather than directly by United Utilities Group PLC.

Notes:

(1) Registered address: 4th Floor, Iyara Building Room 405, 2/22 Chan Road, Thung Wat Don Sub-district, Sathon District, Bangkok, 10120 Thailand.
(2) Registered address: Adala 10, Tallinn 10614, Estonia.
(3) Registered address: Building 200, Road 13, Block 115, Hidd, Kingdom of Bahrain.
(4) Registered address: Al Tamimi & Company, 9th Floor, Dubai World Trade Centre, Sheikh Zayed Road, Dubai, United Arab Emirates.

Five-year summary – unaudited

The financial summary (unaudited) set out below has been derived from the audited consolidated financial statements of United Utilities Group PLC for the five years ended 31 March 2016. It should be read in conjunction with the consolidated financial statements and related notes, together with the strategic report.

Year ended 31 March Continuing operations	**2016** **£m**	2015 £m	2014 £m	2013 £m	2012 £m
Revenue	**1,730.0**	1,720.2	1,688.8	1,636.0	1,564.9
Operating profit per published results	**567.9**	653.3	630.2	601.6	591.5
Underlying operating profit	**604.1**	664.3	634.6	604.2	594.1
Profit before tax per published results	**353.5**	341.6	543.3	311.8	280.4
Underlying profit before tax	**408.1**	447.4	388.1	351.4	327.0
Profit after taxation per published results	**397.5**	271.2	738.6	287.8	311.4
Underlying profit after tax	**325.3**	354.1	304.9	264.2	240.9
Earnings per share (basic) per published results (pence)	**58.3p**	39.8p	108.3p	42.2p	45.7p
Underlying earnings per share (pence)	**47.7p**	51.9p	44.7p	38.7p	35.3p
Dividend per ordinary share (pence)	**38.45p**	37.70p	36.04p	34.32p	32.01p
Non-current assets	**11,280.8**	10,664.8	9,929.6	9,777.8	9,310.9
Current assets	**626.0**	638.8	542.9	630.2	719.9
Total assets	**11,906.8**	11,303.6	10,472.5	10,408.0	10,030.8
Non-current liabilities	**(8,357.1)**	(7,867.7)	(7,660.3)	(7,845.8)	(7,607.0)
Current liabilities	**(844.2)**	(1,001.5)	(596.3)	(690.3)	(659.2)
Total liabilities	**(9,201.3)**	(8,869.2)	(8,256.6)	(8,536.1)	(8,266.2)
Total net assets and shareholders' equity	**2,705.5**	2,434.4	2,215.9	1,871.9	1,764.6
Net cash generated from operating activities	**685.6**	706.5	797.2	631.1	559.8
Net cash used in investing activities	**(676.8)**	(704.9)	(678.6)	(643.8)	(498.4)
Net cash (used in)/generated from financing activities	**(46.4)**	139.2	(211.5)	(115.5)	5.8
Net (decrease)/increase in cash and cash equivalents	**(37.6)**	140.8	(92.9)	(128.2)	67.7
Net debt	**6,260.5**	5,924.0	5,519.9	5,450.6	5,076.4
RCV gearing[1] (%)	**61%**	59%	58%	60%	59%

Note:

(1) Regulatory capital value (RCV) gearing is calculated as group net debt (see note A2), divided by the RCV expressed in out-turn prices, of United Utilities Water Limited.

Shareholder information

Key dates

- **23 June 2016**
  Ex-dividend date for 2015/16 final dividend
- **24 June 2016**
  Record date for 2015/16 final dividend
- **22 July 2016**
  Annual general meeting
- **1 August 2016**
  Payment of 2015/16 final dividend to shareholders
- **23 November 2016**
  Announcement of half-year results for the six months ending 30 September 2016
- **15 December 2016**
  Ex-dividend date for 2016/17 interim dividend
- **16 December 2016**
  Record date for 2016/17 interim dividend
- **1 February 2017**
  Payment of 2016/17 interim dividend to shareholders
- **May 2017**
  Announce the final results for the 2016/17 financial year
- **June 2017**
  Publish the annual report and financial statements for the 2016/17 financial year

Why not make life easy and have your dividends paid straight to your bank?

- 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.

Go to Equiniti for more information via **shareview.co.uk**

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:

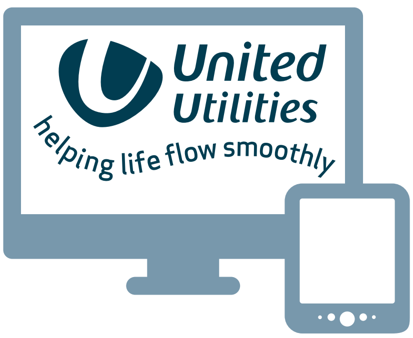
- set up electronic shareholder communication;
- view your shareholdings;
- update your address details if you change your address; and
- get your dividends paid directly into your bank account.

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.

Online annual report

Our annual report is available online. View or download the full annual report and financial statements from:

corporate.unitedutilities.com



To go straight to the investor page on our website scan the QR code with your smartphone

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.

Registrar

The group's registrar, Equiniti, can be contacted on **0371 384 2041** or textphone for those with hearing difficulties: **0371 384 2255**. Lines are open 8.30 am to 5.30 pm, Monday to Friday excluding public 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:
0345 603 7037 and online:
shareview.co.uk/dealing

Equiniti also offers a stocks and shares ISA for United Utilities shares, call **0345 300 0430** or go to: **shareview.co.uk/dealing**

Looking after your investment

We are delighted that our approach to responsible business has again helped us retain a Dow Jones Sustainability Index world-class rating for the eighth consecutive year, and achieve industry leader status for the second time. We also performed strongly in the Carbon Disclosure Project, scoring over 97 per cent for the quality of our disclosure, and secured 90 per cent in BitC's CR index. We have maintained the Carbon Trust Water Standard for our efforts to reduce water use in West Cumbria.

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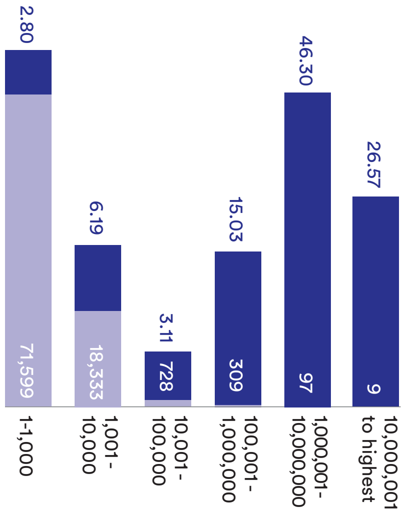
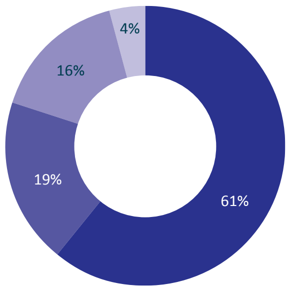
Key shareholder facts

Balance analysis as at 31 March 2016



Shareholders by location



Dividend history – pence per share

	2012	2013	2014	2015	**2016**
Interim	10.67	11.44	12.01	12.56	**12.81**
Final	21.34	22.88	24.03	25.14	**25.64**
Total ordinary	32.01	34.32	36.04	37.70	**38.45**

Warning to shareholders

Please be very wary of any unsolicited contact about your investments or offers of free company reports. It may be from an overseas 'broker' who could sell you worthless or high risk shares. If you deal with an unauthorised firm, you would not be eligible to receive payment under the Financial Services Compensation Scheme. Further information and a list of unauthorised firms that have targeted UK investors is available from the Financial Conduct Authority at

fca.org.uk/consumers/protect-yourself/unauthorised-firms

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