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United Utilities PLC

Annual Report and Financial Statements

31 March 2017

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Terms used in this report:

United Utilities PLC's ultimate parent company is United Utilities Group PLC. 'UUG' means United Utilities Group PLC and 'United Utilities' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings. 'UU' or 'the group' means United Utilities PLC and its subsidiary undertakings.

Cautionary statement:

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

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

Strategic report

Our vision

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

How we create value

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

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

For more information in relation to our values, please see pages 12 to 13 of the 2017 UUG annual report and financial statements.

Our business model

Key resources

Natural Resources

Our 'Instrument of Appointment' or Licence is essential for us to utilise the natural environment in the North West to create value for our business.

Raw water

Rainfall in the North West is greater than in other parts of the country, and therefore water supply is not as constrained. Nonetheless, it is in everyone's interest to make the most of this precious resource. We continuously encourage our customers to use water more efficiently and have increased the number of households fitted with meters. Our water-saving initiatives can save our customers money on their bills as well as preserving this vital resource. We have a regulatory annual leakage target, based on the sustainable economic level of leakage, and we have consistently met or outperformed this target.

Catchment land

We own over 56,000 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 Catchment Wise project is looking at working with others to improve the lakes, rivers and coastal waters where we return wastewater in the North West.

Bioresources

Another key resource is waste. Bioresources from wastewater can be processed to generate renewable energy, helping to save power costs and providing an ongoing opportunity to reduce carbon emissions. Our advanced digestion facility at Davyhulme is one of the largest works of its type and we now inject biogas from Davyhulme's wastewater treatment into the national gas network. We recycle waste by supplying treated bio solids to agriculture, which provides a valuable resource for farmers.

People

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

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Wages and long-term incentives

Our employees are paid a competitive base salary along with a staff benefits offering and the opportunity to join both the employee healthcare scheme and our share incentive plan. Independent studies have shown that this enhances the quality of work, increases employee retention and reduces absenteeism, in addition to 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.

Human resources policies

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, and disabled colleagues have equipment and working practices modified for them, as far as possible, wherever it is safe and practical to do so. We have procedures and policies in place to ensure we act in accordance with the Universal Declaration of Human Rights.

Diverse workforce

We value diversity, providing equality of opportunity and recruiting and promoting employees on the basis of merit, which we believe provides the benefit of a more comprehensive and balanced skills-set. Despite being a highly engineering-based organisation, women are represented at all levels of our company.

Health and safety

The health and safety of our employees is fundamental, both for their welfare and 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 to improve health and safety conditions for our employees, and have been awarded the workplace wellbeing charter.

Supply chain relationships

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. Our suppliers are contributing significantly towards the c£9 billion forecast contribution we are making to the regional economy over the 2015-20 period.

Employee training and development

We place a strong emphasis on providing comprehensive training and development opportunities for our employees, which helps to improve our internal skills-base as well as create a more engaged workforce. We strive to enhance our understanding of best business practices in other companies and sectors around the world and, by bringing this learning back to our business, we have increased our organisational knowledge and capability. This 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 a high calibre of engineers, in a profession which has seen declining numbers in the UK in recent years.

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.

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Long-term solutions

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, and considering the most efficient long-term solutions, we can save future operating costs, help to reduce future customer bills, and work towards being able to operate in a more sustainable manner. It is 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 and cheaper.

Investing in the region

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

2015-20 investment programme

We expect to invest around £3.6 billion across 2015-20 and to continue with a substantial investment programme, for the foreseeable future, in order to meet more stringent environmental standards 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.

Financing

Capital structure

We aim to maintain a robust and responsible capital structure, balancing both equity and debt, to achieve a strong investment grade credit rating. 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 we seek best relative value when issuing new debt.

Controlling our finance costs

Locking in long-term debt at good relative value can help keep our finance costs low and give us the potential 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 changes in the economic and regulatory environment.

External environment

Natural environment

Whether it is 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 in the protection and, where appropriate, enhancement of the natural environment of the North West. This in turn brings economic benefits such as underpinning the region’s tourist industry.

Preparing for climate change

We plan far into the future to ensure we are prepared for the changing natural environment, most notably the risks and opportunities presented by 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. At other times, we must tackle flooding incidents caused by the intensive bursts of rainfall which are becoming more frequent due to changing weather patterns.

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The potential effect of climate change on our future water resources is included in our 25 year Water Resource Management Plan.

Preparing for a changing population

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 without placing too much pressure on customer bills.

Returning water safely to nature

We have a responsibility to return water to the environment safely. Spills from our network can lead to pollution which, depending on their severity, can damage the natural environment and potentially lead to loss of reputation and financial penalties. We have had one of our best years in relation to serious pollution incidents, and it remains an important area of focus. 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 pages 32-33 of the 2017 UUG annual report and financial statements). All of the pollution sub-measures are reported within our Corporate Responsibility pages on our website at: *http://corporate.unitedutilities.com/cr-environment.aspx.*

Reducing our environmental impact

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 CO2 emissions since 2005/06) and have plans to reduce it further. Less than 6 per cent of our waste goes to landfill and our use of recycled products is increasing. We plan to substantially increase our renewable energy production from 2015 to 2020 with the main contributor being solar opportunities. This will provide environmental benefits and energy cost savings.

Political and regulatory environment

Over a long time frame the political and regulatory environment can change significantly. In the 28 years since the UK water industry was privatised, we have seen substantial tightening of laws and regulations. While to some extent changes to the regulatory environment are outside of our direct control, maintaining good relationships 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 to enhance and maintain their assets. Following review of these plans, Ofwat sets the prices each company can charge their customers across the period. This report covers the second year of the 2015-20 (AMP6) period.

Ofwat introduced a number of important changes for the 2015-20 period, 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
- non-household retail – covering customer-facing activities for business customers.

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

The way companies' operating and capital costs are assessed has been modified to encourage them to utilise the most efficient, sustainable solutions under a totex model that looks at capex and opex together and treats them equivalently. Where companies out/underperform their totex allowance, this gain/pain is shared between investors and customers, ensuring both receive the impact.

In a move to a more outcomes-based approach, there was greater emphasis placed on customer engagement to set the outcomes. Companies' performance is now 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 service incentive mechanism (SIM) assessment is continuing to be used as a measure of customer satisfaction. This 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 was published in July 2016 and can be found on our website, where our report for this financial year will also be made available: *corporate.unitedutilities.com*.

Market reform:

From 1 April 2017, the 2014 Water Act opened retail competition to all non-household customers, including sewerage as well as water services. We are well positioned following our experiences in the competitive Scottish market and our JV with Severn Trent, combining our respective non-household retail businesses under Water Plus.

Following a request from Government, Ofwat assessed the potential costs and benefits of extending retail competition to household customers, and recently reported back to Government.

The Water Act paves the way for the future introduction of competition for certain parts of the wholesale, or upstream, business. Ofwat proposed, in its Water 2020 consultation document in 2015, to open up competition in the areas of water resources and sludge treatment from 2020.

We are fully engaged with regards to market reform, being always mindful of the potential impact on our customers and the value implications for our shareholders.

Environmental and quality regulation

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

Competitive environment

The other water companies in England and Wales are naturally our main competitors and we benchmark our performance on a comparative basis. Away from the water sector, in line with our vision to be the best UK water and wastewater company, we benchmark our customer service performance against other leading service providers in our region.

Value creation

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.

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More information about our competitive advantage can be found on pages 13-14 of the 2017 UUG annual report and financial statements.

Performance measurement

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 to deliver the best service to customers, at the lowest sustainable cost, in a responsible manner.

More information about our key financial indicators can be found on pages 32-33 of the 2017 UUG annual report and financial statements

Decision making

Systems Thinking lies at the heart of our day-to-day decision making, 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, communities and other stakeholders. For many years, we have included corporate responsibility factors as strategic considerations, supported by the UUG group's corporate responsibility committee which is chaired by one of UUG's non-executive directors.

More information about our governance can be found on pages 52-117 of the 2017 UUG annual report and financial statements

Economic environment

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

Regional deprivation

In recent years, unemployment in the North West has generally been higher than the national average. However, over the last year this unemployment rate has improved faster than, and is now broadly in line with, the national average. A report from the Department for Communities and Local Government, published during 2015/16, reaffirmed that the North West has the most deprived regions in England, with three of the top five local authority districts with the highest proportion of 'highly deprived' neighbourhoods (categorised as the most deprived 10 per cent). Even as the North West's 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 for 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.

Market rate movements

Interest rates have remained below the long-term trend and we have benefited from this as we drew down, or raised, over £600 million of new debt in 2016/17. Comparatively low interest rates have also been beneficial to our future cost of debt as we continue with our interest rate hedging strategy.

RPI inflation has risen since the UK voted to leave the European Union, increasing to 3.1 per cent at March 2017, following on from lower inflation over the last couple of years. However, RPI inflation remains on the low side versus levels seen in the last 10 years. The prices we charge our customers (and therefore revenues), as well as our asset base, are linked to RPI inflation, so lower RPI has meant slightly lower growth on these measures.

However, we 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 linked to inflation, which provides an additional economic offset against our asset base.

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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.

Economic contribution

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 make purchases from their suppliers and when people, whose jobs are supported by United Utilities, spend their personal incomes.

Social environment

We see some significant societal trends that we plan to address in our long-term strategy.

Population changes

We anticipate an increase in the North West's 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 by looking at new ways to help, like the introduction of our social tariff in 2015, supporting older customers. We are also adapting to the increasing use of social media and digital technology from our stakeholders.

Investing in local communities

The communities in which we operate are of great importance to our business – they are 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.

Technological environment

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.

Energy generation

We have 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. Then in 2015/16 we built Europe's largest floating solar array system on our reservoir in Godley Greater Manchester.

Technological risks

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.

Changing customer behaviours

We must 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 invested in a new digital external communications capability and a number of website improvements.

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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 observe sound and prudent governance in compliance with the principles of the UK Corporate Governance Code.

Prudent risk management

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.

Given the complex legal and regulatory environment within which we operate, we are exposed to a range of risks. 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 and we face risks in relation to potential future changes in legislation or regulation, as well as from environmental impacts such as climate change.

An important risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our finance ability, and that they are agreed by Ofwat as we are bound by these plans for the following five year period with limited opportunity to change them.

See pages 20 to 25 for more details on what we consider to be our principal risks and uncertainties.

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

The governance section on pages 52 to 117 of the 2017 UUG annual report and financial statements presents information on the board of United Utilities and its activities and those of the various UUG board committees. It also sets out how the UUG board demonstrates leadership, effectiveness and its accountability to the group's stakeholders.

Values and culture

Our culture is embodied in our three core values of customer focus, integrity and innovation, and we operate under these three core values at all levels of our business.

These core values are interrelated, as innovating to improve our services and acting with integrity in the way we carry out our activities all help us to continually improve customer service.

Customer focus

Everything we do will be about our customers, not us.

Over recent years, we have instilled a more customer-centric approach right across our organisation, and this evolving culture has been a key driver in 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

Integrity

We will make promises knowingly and keep them.

Acting with integrity, both at board level and as a company, underpins our approach to responsible business and building trust. We actively encourage our employees to express their opinions and ideas through various

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engagement and social channels, such as our annual 'Your Opinion Survey', through news articles on our intranet, and on our social media collaboration tool Yammer.

Innovation

We will innovate to make our services better, safer, faster and cheaper for our customers.

Innovation is a critical enabler in creating value, helping us to be ahead of our competitors, and we welcome ideas on how we can innovate across all levels of our business.

Our employees are given the opportunity to develop and present their ideas to senior management, facilitating and encouraging an innovative environment.

Utilising innovation from our suppliers is part of our supply chain approach, which provides another avenue to benefit from new ideas and technologies.

Our business model

Planning

We have structured our business in line with Ofwat's four distinct price control areas:

- Wholesale water;
- Wholesale wastewater;
- Household retail; and
- Non-household retail.

The non-household retail area is now subsumed within our joint venture with Severn Trent, Water Plus. While we can influence it, we cannot control it. It is not part of our consolidated group, therefore it does not form part of our group's business model.

The three business areas, within our business model (wholesale water, wholesale wastewater, and household retail), undertake both long-term and shorter-term planning to identify how they can best deliver their 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 take into account the internal and external factors described on pages 5 to 9. Underpinning our approach to planning, we undertake a cycle of continuous assessment using KPIs, and other performance measures, which helps us formulate our future improvement plans for our various stakeholders.

Wholesale business areas

All of 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 on the basis of an industry-allowed cost of debt and equity set by Ofwat. Allowed costs for both of these 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.

Retail business areas

Allowed costs within the household retail price control are determined using a water industry average cost to serve approach, rewarding companies who are able to achieve costs below the industry average. The opening of full competition in the non-household retail price control from 1 April 2017 provides a strong incentive for water companies to deliver efficiencies and service improvements in that area.

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Planning – 25 years+

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

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

- climate change and implications for water resources and flooding;
- the emergence of a more open, competitive UK water market;
- more rigorous environmental regulations;
- population growth;
- the implications of the UK's exit from the European Union and; and
- combining affordable bills with a modern, responsive service.

By anticipating and planning ahead, we can ensure that we continue to deliver what customers want at a fair price and in a responsible way, in line with our three strategic themes.

Our Strategic Direction Statement, 'Playing our part to support the North West', sets out our long-term strategy for the next 25 years, examining the challenges ahead and how we will focus our resources and talents in order to meet them.

We consulted with thousands of customers and other stakeholders to ensure their expectations are reflected in our plans.

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

Some of the key ways we create value over the long-term are by:

- investing in our people to ensure a committed, capable and motivated workforce delivering high performance;
- close collaboration with suppliers and disciplined investment, based on a sustainable whole-life cost modelling;
- efficiently implementing a robust and appropriate mix of debt and equity financing;
- 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.

More information can be found at corporate.unitedutilities.com/future.

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Planning – 5 years

Each five year regulatory period is designed to help us achieve our long-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, that contract by providing the best service to customers, at the lowest sustainable cost, in a responsible manner.

Our five year plan for 2010-15 focused on improving customer satisfaction, meeting our statutory obligations and delivering shareholder value. We delivered on each of these, providing us with a strong platform to deliver further in 2015-20.

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

- ***Improve customer service –*** improving efficiency and reducing costs, as well as improving our SIM performance to increase rewards /reduce penalties from Ofwat.
- ***Enhance our debt collection activities*** – reducing retail costs, whilst providing the best support for customers struggling to pay.
- ***Minimise total costs on a sustainable basis*** – for example power, materials and property rates, which will help us to meet or outperform our allowed totex costs.
- ***Raise low-cost finance*** – helping us to outperform our allowed finance costs, which is our main area of outperformance potential in this period.
- ***Deliver our operational and regulatory commitments*** – helping to ensure we achieve high levels of customer service and meet environmental standards as well as improving our ODI performance to increase rewards / reduce penalties from Ofwat, in areas such as reliably delivered high-quality water, and reducing pollution and sewer flooding incidents.
- ***Implement our hedging strategies*** – fixing medium term interest rates and power costs helps us to meet our allowance by reducing the volatility of these costs.
- ***Increase our production of renewable energy from waste –*** protecting us from rising energy costs and reducing our carbon footprint.
- ***Maintain a robust supply/demand balance*** – providing water resource and customer supply benefits, as well as avoiding any penalties or unfunded expenditure requirements from our regulators.

Supporting this value generation, each of our 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.

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Wholesale wastewater

- build on the customer satisfaction improvements we have already delivered. Continue to improve the way we operate, 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, and work with other organisations to support them in delivering improvements to our region's beaches;
- improve 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.

Household 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 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 return to sustained payment behaviour. We are extending our options for assistance to hard-pressed customers, including the social tariff, and we remain committed to contributing 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 improvements. 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.

Planning – 1 year

Each financial year we develop a business plan which is approved by the UUG board. This sets our annual targets which are designed to help deliver further improvements and move us towards achievement of our five year goals.

Our business plan covers a broad range of measures across the three strategic themes: delivering the best service to customers, at the lowest sustainable cost, in a responsible manner.

Performance monitoring

Senior management has quarterly business review meetings with the executive directors to monitor and assess our performance against these measures, helping to ensure that we are on track to deliver our targets.

Performance measurement

At the end of every financial year, our performance is assessed against these 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.

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Details of the 2016/17 annual bonus and vested long-term incentive plans for our executive directors can be found on pages 100 and 101 respectively within the remuneration report of 2017 UUG annual report and financial statement.

More information about our key financial indicators can be found on page 33 of the 2017 UUG annual report and financial statements.

Systems Thinking

Underpinning the improvements in our operational performance is our drive toward Systems Thinking. This means thinking of our entire network of assets as one big system, and managing it as such.

In this regulatory period, we are investing in our new wholesale operating model and are progressing the roll-out of this unique capability. Our production line model is well established, and we opened our Integrated Control Centre (ICC) in April 2015. This has increasingly become 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, and we have improved asset availability.

We are using more sensors in our network and better analysing other data, such as weather forecasting, to help reduce costs, 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.

Strategic themes and outcomes

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

The best service to customers:

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

At the lowest sustainable cost:

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

Strategic report

In a responsible manner:

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

Key performance indicators

Financial KPIs

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

	Year ended 31 March 2017	Year ended 31 March 2016
Financial KPIs		
Revenue	£1,704m	£1,730m
Underlying operating profit (1)	£623m	£604m
Underlying profit before tax (1)	£417.2m	£436.0m
Underlying profit after tax (1)	£335.7m	£347.7m
Regulatory capital expenditure (2)	£804m	£799m
Gearing: net debt to regulatory capital value (3)	61%	61%
Performance summary		
Operating profit	£606m	£568m
Profit before tax	£470m	£381m
Profit after tax	£456m	£420m

Notes:
(1) Underlying profit measures have been provided to give a more representative view of business performance and represent non-GAAP measures that are reconciled to reported measures on page 19. Further details of underlying profit measures can be found on pages 44-45 of the UUG 2017 Annual Report.
(2) Regulatory capex represents fixed asset additions and infrastructure renewals expenditure using regulatory accounting guidelines; there is no equivalent GAAP measure.
(3) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water RCV (out-turn prices).

Financial performance

Revenue

Revenue was down £26 million, at £1,704 million, reflecting the impact of our Water Plus JV, which completed on the 1 June 2016, partly offset by our allowed regulatory revenue changes.

With regard to Ofwat's revenue correction mechanism, relating to the 2014/15 financial year, we have £9.5 million to return to customers. As we have previously indicated, we propose to return the £9.5 million to customers through revenue reductions of c£3 million in 2017/18, c£3 million in 2018/19 and c£3 million in 2019/20 to help aid a smoother bill profile.

Separately, consistent with Ofwat's annual wholesale revenue forecasting incentive mechanism (WRFIM), we will also be reducing 2017/18 revenue by £7 million as actual volumes in 2015/16 were higher than our assumptions increasing revenue by 0.4 per cent.

Strategic report

Operating profit

Underlying operating profit at £623 million was £19 million higher than last year. This reflects our allowed regulatory revenue changes, a reduction in infrastructure renewals expenditure, an improvement in our bad debt charges and a small reduction in the remaining cost base, partly offset by the accounting impact of our Water Plus JV. The JV completed on 1 June 2016 and, from that date, its contribution is no longer included within operating profit and is, instead, included within the share of profits of joint ventures line in the income statement. However, as expected, due to start-up costs, our share of 2016/17 losses of the Water Plus JV was around £2 million.

Reported operating profit increased by £38 million, to £606 million, reflecting the increase in underlying operating profit, along with a reduction in adjusted items. Adjusted items for 2016/17 amounted to £17 million, £10 million of which related to restructuring costs. Adjusted items in the prior year amounted to £36 million, £25 million of which related to the water quality incident in summer 2015.

Investment income and finance expense

The underlying net finance expense of £210 million was £36 million higher than last year, mainly due to the impact of higher RPI inflation on the group's index-linked debt, particularly on the portion of index-linked debt with a three-month lag. Interest on non index-linked debt of £108 million was £4 million lower than last year, due to the lower rates locked in on our interest rate swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £81 million, compared with a net charge of £38 million last year. As at 31 March 2017, the group had approximately £3.6 billion of index-linked debt at an average real rate of 1.3 per cent.

The higher RPI inflation charge compared with last year contributed to the group's average underlying interest rate of 3.8 per cent being higher than the rate of 3.4 per cent for the year ended 31 March 2016. The average underlying interest rate represents the underlying net finance expense divided by average debt.

Reported net finance expense of £161 million was lower than the £192 million expense in 2015/16. This £31 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £26 million loss in 2015/16 to a £24 million gain in 2016/17. The fair value gain in the current year is due to the net receipts on swaps and debt under fair value option and gains on our electricity swap portfolio due to an increase in the market price of electricity. Losses in the prior year were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. 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 Ofwat at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015-20 regulatory period.

Profit before tax

Underlying profit before tax was £417 million, £19 million lower than last year, as the £19 million increase in underlying operating profit was more than offset by the £36 million increase in underlying net finance expense. This underlying measure reflects the adjusting items, 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 19.

Reported profit before tax significantly increased by £89 million to £470 million, due in most part to fair value movements and the increase in reported operating profit, as well as a £22 million profit on disposal of the non-household retail business.

Tax

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £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.

In 2016/17, we paid corporation tax of £42 million, which represents an effective cash tax rate on underlying profits of 11 per cent, which is 9 per cent lower than the headline rate of corporation tax of 20 per cent.

Strategic report

Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes fair value movements on debt and derivative instruments and thereby enables a medium-term cash tax rate forecast. 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 £60 million in 2016/17, compared with £59 million in the previous year. There were current tax credits of £23 million in 2016/17 and £9 million in 2015/16, following agreement of prior years' tax matters; in addition to UK tax, the current year figure also included the release of a provision in relation to agreed historic overseas tax matters.

For 2016/17, the group recognised a deferred tax charge of £28 million, compared with a charge of £19m for 2015/16. In addition, in 2016/17 the group recognised a deferred tax charge of £7 million relating to prior years' tax matters, compared with a charge of £6 million in 2015/16. In 2016/17, the group also recognised a deferred tax credit of £58 million relating to the enacted reduction in the headline rate of corporation tax from 18 per cent to 17 per cent from 1 April 2020. This compares to a deferred tax credit of £112 million in 2015/16 when the enacted reduction in the headline rate of corporation tax from 1 April 2020 was reduced from 20 per cent to 18 per cent.

The total tax charge for 2016/17 was £14 million as compared to a total tax credit of £39 million for 2015/16, the main difference being the £58 million reduction in the deferred tax credit relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium-term.

Profit after tax

Underlying profit after tax of £336 million was £12 million lower than last year, principally reflecting the £19 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits.

Reported profit after tax was higher at £456 million, compared with £420 million in the previous year, as the £89 million increase in the reported profit before tax was partly offset by the £58 million higher tax charge.

Strategic report

Underlying profit

Underlying profit measures have been provided to give a more representative view of business performance and represent non-GAAP measures that are reconciled to reported measures below. Further details of these measures can be found on pages 44-45 of the UUG 2017 Annual Report.

	Year ended 31 March 2017	Year ended 31 March 2016
Operating profit	£m	£m
Operating profit per published results	605.5	567.9
Water quality incident	-	24.8
Flooding incidents (net of insurance proceeds recognised)	1.5	(0.6)
Business retail market reform (1)	5.8	11.1
Restructuring costs	10.1	0.9
Underlying operating profit	622.9	604.1
Net finance expense		
Finance expense	(202.7)	(224.4)
Investment income	41.5	32.9
Net finance expense per published results	(161.2)	(191.5)
Adjustments:		
Net fair value (gains)/ losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest (income)/expense	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Underlying net finance expense	(209.5)	(173.1)
Profit before tax		
Share of profits of joint ventures	3.8	5.0
Profit before tax per published results	470.2	381.4
Adjustments:		
Water quality incident	-	24.8
Flooding incidents	1.5	(0.6)
Business retail market reform (1)	5.8	11.1
Restructuring costs	10.1	0.9
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest (income)	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Profit on disposal of business	(22.1)	-
Underlying profit before tax	417.2	436.0
Profit after tax		
Underlying profit before tax	417.2	436.0
Reported tax (charge)/credit	(14.0)	38.5
Deferred tax credit – change in tax rate	(58.2)	(112.5)
Agreement of prior years' tax matters	(15.5)	(3.4)
Tax in respect of adjustments to underlying profit before tax	6.2	(10.9)
Underlying profit after tax	335.7	347.7

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

Strategic report

Principal risks and uncertainties

Our risk management approach supports our focus on customer service, resilience, reputation and shareholder value

Our strategy is to create sustainable value by delivering the best service to customers, at the lowest sustainable cost and in a responsible manner. In doing this, the group is exposed to a range of internal and external risks of varying types which can impact upon us and the delivery of our objectives and operations. To understand and manage these risks, we maintain a risk management framework which includes:

- an enterprise-wide approach to risk management;
- a well-established governance and reporting structure;
- a risk assessment and management process which is aligned to ISO 31000:2009; and
- a suite of tools, guidance material and training packages to support consistency of approach.

Key features and developments

Our risk profile shows that, for each set of the ten highest ranked risks (one set for each of group wide business risks and wholesale operational risks), the majority fall into the principal risk areas ‘Political and regulatory’, ‘Water service’ and ‘Wastewater service’. Operationally, the dominance of the penalty element of the outcome delivery incentive mechanism and the effect following changes to the Environmental Sentencing Guidelines are key features of this exposure. Reputationally, our core operations/service provision (notably water service) and health safety and environmental risks have the highest focus for monitoring and reviewing control effectiveness based on the potential impact should the risk event occur.

We aim for continuous improvement in both our governance and approach to managing risk. Changes this year include the introduction of a core risk team and additional sign-off processes relating to operational risk. We have also developed a programme focused on long term resilience of assets, overseen by the newly formed wholesale resilience board. Associated with this is a focus on asset health and operational hazard risk assessment in advance of and beyond the 2015-20 regulatory period. This should ensure that we fully understand the long-term risk profile of our asset base and improve our capability to deliver the most cost-effective and proportionate risk management response. Other developments include an ongoing transformation programme (with the Drinking Water Inspectorate) to address some areas of concern arising from the Lancashire incident in 2015, system optimisation in wastewater services through a remote monitoring and control transformation project and in domestic retail a customer service improvement plan underpinned by a clear strategy, improved complaints handling, accurate data and cultural change.

The introduction of non-household retail competition required significant preparation. Ensuring we continue to operate compliantly and in accordance with ‘level playing field’ requirements remains a key area of focus.

Whilst most of our operations are in the UK, the potential effects of 'Brexit' have been considered, assessed and reported to the group board. Like many companies, a key issue is the level of uncertainty that exists. Our assessment included sources of funds, costs of goods and services, our ability to collect cash in the event of an economic downturn and the effect of any potential inflationary shift over current predictions. This area remains under review.

Looking further ahead, the expected introduction of competition in relation to certain wholesale activities and the possible introduction of competition in the provision of household retail activities at some future date all place risk on the group.

It is also important to acknowledge other potential significant change in environment and societal conditions. Climate change is expected to be one of the sector’s biggest challenges having significant and permanent implications on the water cycle and the long-term sustainability of water and wastewater services including water abstraction, supply and treatment capability, drainage and sewer capacity and wastewater treatment and discharge efficiency and effectiveness.

Strategic report

Material litigation

The group robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible. Litigation of a material nature is regularly reported to the group board. Two cases of particular note are as follows, 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 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 UUW's position on the remainder of the proceedings. MSCC have now instigated further heads of claim against UUW in order that they may continue to challenge UUW's rights to discharge water and treated effluent into the canal.

Principal risks and uncertainties

1. Political and regulatory risk

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

Current key risks, issues or areas of uncertainty include:

- Market reform including non-household and upstream competition and, further ahead, the potential for the introduction of household competition
- A possible change from using the retail prices index to the consumer prices index for regulatory indexation
- Brexit

Potential impacts

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

Control mitigation

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

2. Compliance risk

The potential failure to meet all legal and regulatory obligations and responsibilities.

Current key risks, issues or areas of uncertainty include:

- Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market

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- Current material litigation
- New higher fine levels for environmental offences

Potential impacts

Reputational, brand and general damage arising from 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.

Control mitigation

Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any material additional compliance costs in the regulated business is sought as part of the price determination process. The group also robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible.

3. Water and wastewater service

The potential failure of water and wastewater operational processes or assets.

Current key risks, issues or areas of uncertainty include:

- Water quality
- Interruption to supply
- Pollution
- Population growth and climate change
- Meeting infrastructure investment requirements
- Expected change to the abstraction licensing regime

Potential impacts

Operational performance problems or service or asset failures can lead to a failure to provide a secure supply of clean, safe drinking water or an inability to remove, treat and return water to the environment. This can cause public health, community and environmental impacts, additional operating or capital expenditure and/ or increased regulatory scrutiny and regulatory penalties. In more extreme situations the group could also be fined for breaches of statutory obligations, be subject to enforcement action, be held liable to third parties and sustain reputational damage.

Control mitigation

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

4. Retail and commercial risk

Potential inability to provide good and fair service to domestic customers and third party retailers

Current key risks, issues or areas of uncertainty include:

- Socio-economic deprivation in the North West
- Welfare reform and the impact on domestic bad debt

Strategic report

- Competition in the water and wastewater market and competitor positioning
- Market reform and the ability to treat other participants equally

Potential impacts

Poor service to customers can result in financial penalties and an impact on regulatory reputation. The opening of the market for retail services to all non-household customers in England in April 2017 has generated both opportunities and risk for the group and its associated business retail function in respect of income, margin and debt. Breaches of legal and regulatory requirements could lead to fines, penalties and reputational damage. Uncertainty remains in respect of potential upstream reform from 2020.

Control mitigation

For domestic retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Within our wholesale department processes, systems, data and organisational capacity and capability to deal with market participants and the central market operator have been delivered. 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.

5. Financial risk

Potential inability to appropriately finance the business.

Current key risks, issues or areas of uncertainty include:

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

Potential impacts

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

Control mitigation

Refinancing is long-term with staggered maturity dates to minimise the effect of short-term downturns.

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

6. Programme delivery risk

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

Current key risks, issues or areas of uncertainty include:

- Security of supply

Strategic report

- Delivery of solutions
- Quality and innovation
- New contract delivery partnerships for the 2015-2020 period with a new approach to construction and design

Potential impacts

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

Control mitigation

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

7. Resource risk

The potential inability to provide appropriate resource (human, system, technological or physical) required to support business activity.

Current key risks, issues or areas of uncertainty include:

- Delivering required employee engagement
- Personal development and talent management
- Technological innovation
- Asset management

Potential impacts

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

Control mitigation

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

Strategic report

8. Security risk

The potential inability to protect people, information, infrastructure and non-infrastructure from malicious or accidental activity.

Current key risks, issues or areas of uncertainty include:

- Ownership and operation of National Infrastructure and Critical National Infrastructure
- Cybercrime and terrorism

Potential impacts

Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) which could impact the provision of vital services and/or harm people or commercial businesses. In addition commercial or sensitive information could be lost.

Control mitigation

Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Recent initiatives include awareness training across the business relating to seven key areas of security and the implementation of a security governance model to oversee all aspects of security and security strategy. Ongoing system and network integration improves operational resilience and we maintain robust incident response, business continuity and disaster recovery procedures. We also maintain insurance cover for loss and liability and the licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers in the event of a catastrophic incident.

9. Health, safety and environmental

Potential for operational or natural hazards to affect employees, contractors, the public or the environment.

Current key risks, issues or areas of uncertainty include:

- Extreme weather conditions
- Excavation, tunnelling and construction work
- Working with substances hazardous to human health
- Working with water and wastewater
- Driving and vehicle movement

Potential impacts

Working with and around water, sewage, construction and excavation sites, plant and equipment exposes people and the environment to man-made and naturally occurring hazards. This could result in harm to people, wildlife and natural habitats and lead to increased work down-time and additional operational costs, for example environmental clean-up. Depending on the circumstances, the group could be fined heavily for breaches of statutory obligations, be held liable to compensate third parties and sustain severe reputational damage.

Control mitigation

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

The Strategic report was approved by the board on 9 June 2017 and signed on its behalf by:

JR Houlden
Chief Financial Officer

Directors’ report

The directors present their report and the audited financial statements of United Utilities PLC and its subsidiaries for the year ended 31 March 2017.

Profit and dividends

The results for the year, set out in the consolidated income statement on page 32 show that profit for the year after tax was £456.2 million (2016: £419.9 million).

The directors have not recommended a final ordinary dividend (2016: £nil). Interim ordinary dividends of £263.1 million (2016: £258.7 million) have been declared and paid during the year.

Principal activity and review of business

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

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

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

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

Political donations

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

The group incurred expenditure of £11,298 (2016: £5,360) as part of this process. At the 2016 AGM, an authority was taken to cover such expenditure. A similar resolution will be put to our shareholders at the 2017 AGM to authorise the company and its subsidiaries to make such expenditure.

Research and development

The group undertakes research primarily to provide improved standards of service to customers, together with continuing improvements in business efficiency. Its intention is to strengthen its understanding of science and technology in relation to its range of wastewater and water treatment processes to ensure that treatment plants are able to meet the required current and future standards of environmental performance whilst being operated in a cost-effective and efficient manner.

The group is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The group also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the group and charged to the income statement was £2.3 million in the year ended 31 March 2017 (2016: £2.3 million).

Carbon footprint

The group is committed to reducing its carbon footprint and increasing its generation of renewable energy. In 2016/17, the group’s carbon footprint totalled 452,301 tonnes of carbon dioxide equivalent, which is a 23 per cent reduction over the last 10 years. For further information please visit *corporate.unitedutilities.com/cr-environment.*

Directors' report

Events after the reporting period

There were no events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2017.

Going concern basis of accounting

The directors consider it appropriate to prepare the financial statements on the going concern basis, as explained in the basis of preparation paragraph on page 38.

Directors

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

PA Aspin
SR Fraser
JR Houlden
SL Mogford

Directors' indemnities and insurance

We have in place contractual entitlements for the directors of the company and of its subsidiaries to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third party indemnity provision and qualifying pension scheme indemnity provision, have been established in compliance with the relevant provisions of the Companies Act 2006 and have been in force throughout the financial year. They include provision for the company to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of the company or its subsidiaries. The company also maintains an appropriate level of directors' and officers' liability insurance.

Employees

Our policies on employee consultation and on equal opportunities for its disabled employees can be found on page 4. The company's business principles make clear how it and all our employees must seek to act with integrity and fairness and observe legal requirements. Anyone with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or through a confidential telephone line.

Importance is placed on strengthening employees' engagement, measuring their views annually, then taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information to enable them to understand the financial and economic factors affecting the company's performance. The board encourages employees to own shares in the company through the all employee share incentive plan (ShareBuy). For further information on our average number of employees during the year, see note 2 on page 43.

Financial instruments

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

Share capital

At 31 March 2017, the issued share capital of the company was £881,787,478 divided into 881,787,478 ordinary shares of £1 each. Details of our share capital and movements in our issued share capital are shown in note 21 to the financial statements on page 59.

Directors' report

Internal controls and risk management

The board is responsible for ensuring that the company has sound risk management and internal control systems in place, and for reviewing its effectiveness. It is supported in this role by the audit committee of UUG, the internal audit function, the financial control team and the external auditor. The key features of this internal control framework include policies and procedures for planning, approving and monitoring major capital expenditure and clearly defined comprehensive business planning and financial reporting procedures, and monthly meetings by the executive team to review financial and non-financial performance and key operational issues. Alongside these processes, risk management is well embedded in our ongoing business as usual approach. All areas of the business and support departments are responsible for monitoring changes to their areas of activity, identifying any associated risks as a result of these changes which might prevent us from achieving our objectives, and identifying actions to mitigate those risks as far as is reasonably practicable and cost-effective to do so. These internal control and risk management systems, which are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss, have been in place continually for the year under review. On behalf of the board, the audit committee of UUG completed its annual review of the effectiveness of the risk management and internal control processes up to the date of the annual report in accordance with the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. There were no significant failings or weaknesses identified in this review.

The principal risks and uncertainties to the business are explained on pages 20 to 25. We continue to work with all key parties to represent the best interests of our stakeholders, and where we can identify actions to mitigate the adverse consequences of these risks we work hard to address them.

Information given to the auditor

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

1. so far as he is aware, there is no relevant audit information of which the company's auditor is unaware; and
2. he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information. This confirmation is given, and should be interpreted, in accordance with the provisions of s418 of the Companies Act 2006.

External auditor

KPMG are appointed as statutory auditor to all wholly owned companies in the United Utilities group. The company adheres to the UUG policy on non-audit services provided by the external auditor and in relation to auditor independence (see page 77 of the 2017 UUG annual report and financial statements).

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

Approved by the board and signed on its behalf by:

JR Houlden
Chief Financial Officer
9 June 2017

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

The directors are responsible for preparing the Annual Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with IFRSs as adopted by the EU and applicable law.

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

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

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

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

Independent auditor's report

to the members of United Utilities PLC

We have audited the financial statements of United Utilities Plc for the year ended 31 March 2017 set out on pages 32 to 96. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 29, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2017 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

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

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

Independent auditor's report

to the members of United Utilities PLC

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

William Meredith (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
St Peter's Square, Manchester, M2 3AE.
9 June 2017

Consolidated income statement

for the year ended 31 March

	Note	2017 £m	2016 £m
Revenue	1	1,704.0	1,730.0
Employee benefits expense	2	(151.9)	(146.9)
Other operating costs	3	(435.1)	(485.8)
Other income	3	4.2	3.6
Depreciation and amortisation expense	3	(364.9)	(363.7)
Infrastructure renewals expenditure		(150.8)	(169.3)
Total operating expenses		(1,098.5)	(1,162.1)
Operating profit		605.5	567.9
Investment income	4	41.5	32.9
Finance expense	5	(202.7)	(224.4)
Investment income and finance expense		(161.2)	(191.5)
Profit on disposal of business	8	22.1	-
Share of profits of joint ventures		3.8	5.0
Profit before tax		470.2	381.4
Current tax charge	6	(37.0)	(49.8)
Deferred tax charge	6	(35.2)	(24.2)
Deferred tax credit – change in tax rate	6	58.2	112.5
Tax	6	(14.0)	38.5
Profit after tax		456.2	419.9

All of the results shown above relate to continuing operations.

Consolidated statement of comprehensive income

for the year ended 31 March

	Note	2017 £m	2016 £m
Profit after tax		456.2	419.9
Other comprehensive income			
Remeasurement (losses)/gains on defined benefit pension schemes	17	(76.7)	160.1
Tax on items taken directly to equity	6	17.3	(26.5)
Foreign exchange adjustments		3.7	3.0
Total comprehensive income		400.5	556.5

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

	Note	Group 2017 £m	Group 2016 £m	Company 2017 £m	Company 2016 £m
ASSETS					
Non-current assets					
Property, plant and equipment	9	10,405.5	10,031.4	-	-
Intangible assets	10	187.7	162.4	-	-
Interests in joint ventures	11	75.2	35.1	39.1	-
Investments	12	9.0	8.7	4,181.2	4,209.6
Trade and other receivables	14	1,777.7	1,639.4	1,674.4	1,636.9
Retirement benefit surplus	17	247.5	275.2	53.0	48.3
Derivative financial instruments	A4	731.0	765.5	187.0	141.4
		13,433.6	12,917.7	6,134.7	6,036.2
Current assets					
Inventories	13	22.4	29.3	-	-
Trade and other receivables	14	312.6	376.9	1,612.6	1,560.0
Current tax asset		7.1	-	-	-
Cash and short-term deposits	15	247.8	213.6	50.2	7.3
Derivative financial instruments	A4	76.7	0.1	0.3	-
Assets classified as held for sale	8	-	15.6	-	-
		666.6	635.5	1,663.1	1,567.3
Total assets		14,100.2	13,553.2	7,797.8	7,603.5
LIABILITIES					
Non-current liabilities					
Trade and other payables	20	(589.3)	(530.5)	-	-
Borrowings	16	(7,058.4)	(6,508.8)	(815.8)	(730.5)
Deferred tax liabilities	18	(1,031.5)	(1,062.0)	(8.6)	(8.0)
Derivative financial instruments	A4	(235.5)	(255.8)	-	-
		(8,914.7)	(8,357.1)	(824.4)	(738.5)
Current liabilities					
Trade and other payables	20	(329.1)	(346.8)	(99.1)	(161.8)
Borrowings	16	(386.8)	(524.5)	(907.8)	(815.5)
Current tax liabilities		-	(12.3)	-	-
Provisions	19	(26.5)	(15.1)	-	-
Derivative financial instruments	A4	(14.2)	(5.9)	-	(0.7)
		(756.6)	(904.6)	(1,006.9)	(978.0)
Total liabilities		(9,671.3)	(9,261.7)	(1,831.3)	(1,716.5)
Total net assets		4,428.9	4,291.5	5,966.5	5,887.0
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	21	881.8	881.8	881.8	881.8
Share premium account		1,430.0	1,430.0	1,430.0	1,430.0
Cumulative exchange reserve		(2.0)	(5.7)	-	-
Retained earnings		2,119.1	1,985.4	3,654.7	3,575.2
Shareholders' equity		4,428.9	4,291.5	5,966.5	5,887.0

These financial statements for the group and United Utilities PLC (company number: 2366616) were approved by the board of directors and authorised for issue on 9 June 2017, and signed on its behalf by:

JR Houlden
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
Group					
At 1 April 2016	881.8	1,430.0	(5.7)	1,985.4	4,291.5
Profit after tax	-	-	-	456.2	456.2
Other comprehensive Income					
Remeasurement losses on defined benefit pension schemes (see note 17)	-	-	-	(76.7)	(76.7)
Tax on items taken directly to equity (see note 6)	-	-	-	17.3	17.3
Foreign exchange adjustments	-	-	3.7	-	3.7
Total comprehensive income	-	-	3.7	396.8	400.5
Dividends (see note 7)	-	-	-	(263.1)	(263.1)
At 31 March 2017	881.8	1,430.0	(2.0)	2,119.1	4,428.9

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

Company statement of changes in equity

for the year ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2016	881.8	1,430.0	3,575.2	5,887.0
Profit after tax	-	-	347.1	347.1
Other comprehensive income				
Remeasurement losses on defined benefit pension schemes (see note 17)	-	-	(6.3)	(6.3)
Tax on items taken directly to equity (see note 6)	-	-	1.8	1.8
Total comprehensive income	**-**	**-**	342.6	342.6
Dividends (see note 7)	-	-	(263.1)	(263.1)
At 31 March 2017	881.8	1,430.0	3,654.7	5,966.5

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

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The results of the company for the financial year was a profit after tax of £347.1 million (2016: £278.4 million).

Consolidated and company statements of cash flows

for the year ended 31 March

		Group		Company	
		2017	2016	2017	2016
	Note	£m	£m	£m	£m
Operating activities					
Cash generated from operations	A1	981.7	869.8	325.7	276.8
Interest paid		(161.0)	(168.7)	(29.7)	(22.5)
Interest received and similar income		33.4	29.5	1.2	0.2
Tax paid		(42.4)	(53.1)	(42.4)	(53.1)
Tax received		1.2	-	-	-
Net cash generated from operating activities		812.9	677.5	254.8	201.4
Investing activities					
Purchase of property, plant and equipment		(672.4)	(634.2)	-	-
Purchase of intangible assets		(52.4)	(66.1)	-	-
Proceeds from sale of property, plant and equipment		4.1	1.4	-	-
Grants and contributions received	20	29.0	17.3	-	-
Loans to joint ventures	A6	(109.0)	-	-	-
Investment in joint ventures	11	(13.5)	-	(13.5)	-
Proceeds from investments	12	0.9	0.2	-	-
Proceeds from disposal of business	8	3.3	-	3.3	-
Dividends received from joint ventures		5.4	4.6	-	-
Net cash used in investing activities		(804.6)	(676.8)	(10.2)	-
Financing activities					
Proceeds from borrowings		741.8	694.6	95.7	29.2
Repayment of borrowings		(448.7)	(474.1)	(34.3)	(26.2)
Dividends paid to equity holders of the company	7	(263.1)	(258.7)	(263.1)	(258.7)
Net cash generated from/(used in) financing activities		30.0	(38.2)	(201.7)	(255.7)
Net increase/(decrease) in cash and cash equivalents		38.3	(37.5)	42.9	(54.3)
Cash and cash equivalents at beginning of the year		182.6	220.1	7.3	61.6
Cash and cash equivalents at end of the year	15	220.9	182.6	50.2	7.3

Accounting policies

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

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). They have been prepared on the historical cost basis, except for the revaluation of financial instruments, accounting for the transfer of assets from customers and the revaluation of infrastructure assets to fair value on transition to IFRS.

The preparation of financial statements, in conformity with IFRS, requires management to make estimates and assumptions that affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting periods presented. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates.

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

In assessing the appropriateness of the going concern basis of accounting, the directors have reviewed the resources available to the group, taking account of the group's financial projections, together with available cash and committed borrowing facilities as well as consideration of the group's capital adequacy, consideration of the primary legal duty of United Utilities Water Limited (UUW) 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 2017, have had no material impact on the group's financial statements.

- Amendments to IAS 1 'Disclosure Initiative', in respect of improved financial statement disclosures;
- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations', requiring business combination accounting to be applied; and
- Improvements to IFRS (2014), 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. Changes to these estimates, judgements and assumptions could have a material effect on the financial statements.

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

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

Accounting policies

Revenue recognition and allowance for doubtful receivables

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

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

Accounting estimate **-** UUW 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.

Property, plant and equipment

Accounting judgement **-** the group recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure requires an accounting judgement, particularly when projects have both elements within them. In addition, management capitalises time and resources incurred by the group's support functions on capital programmes, which requires accounting judgements to be made in relation to the appropriate capitalisation rates.

Accounting estimate **-** the estimated useful economic lives of PPE are based on management's experience. When management identifies that actual useful economic lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of PPE investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively and, as such, this is a key source of estimation uncertainty, although historically few changes to estimated useful economic lives have been required.

Accounting estimate **-** the group is required to evaluate the carrying values of PPE for impairment whenever circumstances indicate, in management's view, that the carrying value of such assets may not be recoverable. An impairment review requires management to make uncertain estimates concerning the cash flows, growth rates and discount rates of the cash generating units under review.

Retirement benefits

Accounting estimate **-** the group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. 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, which are used to estimate the present value of defined benefit obligations. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note A5.

Accounting estimate **-** 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

Accounting policies

and economic conditions and longer or shorter lives of participants and, as such, this represents a key source of estimation uncertainty.

Tax

Accounting judgement **-** 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.

Derivative financial instruments

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

Provisions and contingencies

Accounting judgement **-** the group is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual, employment and environmental 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.

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

New and revised standards not yet effective

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

IFRS 9 'Financial Instruments'

The standard is effective for periods commencing on or after 1 January 2018. 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, an £11.9 million loss 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, £0.8 million of fair value losses would have been recognised in other comprehensive income rather than within the income statement.

In addition, the standard requires entities to use an expected credit loss model for impairment of financial assets instead of an incurred credit loss model. This is expected to impact the way in which the group provides for bad and doubtful receivables. Work in this area is ongoing and it is not currently possible to quantify the expected impact as this will be dependent on the design of the model and the economic circumstances at the point of implementation; however, the current expectation is that it is unlikely to have a material impact on the overall level of provisions.

Accounting policies

IFRS 15 'Revenue from Contracts with Customers'

The standard is effective for periods commencing on or after 1 January 2018. This standard introduces a new revenue recognition model and replaces IAS 18 'Revenue', IAS 11 'Construction Contracts', IFRIC 13 'Customer Loyalty Programmes', IFRIC 15 'Agreements for the Construction of Real Estate', IFRIC 18 'Transfer of Assets from Customers' and SIC-31 'Revenue – Barter Transactions Involving Advertising Services'. While the introduction of IFRS 15 is expected to have a significant impact for many companies, the directors have carefully considered the potential effects in the context of the group's revenues and have concluded that on adoption there will be no significant changes to the way in which the group's performance obligations to customers are identified or deemed to be satisfied and, therefore, no material impact on the revenues recognised in the financial statements.

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.

If the standard had been adopted in the current year a depreciation charge of around £4 million in relation to the right-of-use asset and a finance expense charge of around £1 million would have been recognised in the income statement in place of the operating lease charge of £4.4 million. In addition, a right-of-use asset and largely offsetting lease liability of around £105 million would be recognised in the statement of financial position, assuming application of the modified retrospective transitional approach as permitted by the standard and current incremental costs of borrowing. The actual impact on adoption will be sensitive to the incremental costs of borrowing at the 1 April 2019 application date.

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

Notes to financial statements

1. Revenue and segment reporting

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

The group has a large and diverse domestic retail customer base and there is no significant reliance on any single customer in this area. Following the sale of the group's non-household business on 1 June 2016 (see note 8), £402.7 million (2016: £nil) of the group's revenue from wholesale water and wastewater services during the year was derived from sales to Water Plus Group Limited (Water Plus), a joint venture formed during the year between United Utilities PLC and Severn Trent PLC, and its subsidiaries. Please see notes A4 and A6 for further details.

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

2. Directors and employees

Directors' remuneration

	2017 £m	2016 £m
Salaries	1.7	1.7
Benefits	0.4	0.4
Bonus	0.8	0.6
Share-based payment charge	1.8	1.1
	4.7	3.8

Included within the above are aggregate emoluments of £2.2 million (2016: £1.8 million) in respect of the highest paid director. The highest paid director exercised share options during the current year.

No directors accrued benefits under defined benefit schemes during the current year (2016: no directors). All directors opted for a cash allowance in lieu of their company pension scheme entitlement (2016: all directors).

Four directors (2016: four directors) received shares in United Utilities Group PLC in respect of qualifying services, and two directors (2016: three directors) exercised nil-cost share options in United Utilities Group PLC during the year. Four directors (2016: four directors) had long-term incentive plans which vested during the year. Aggregate amounts receivable relating to long-term incentive plans of £2.4 million (2016: £2.4 million) were recognised during the year. Details of the employee Sharebuy scheme and the executive share scheme operated by United Utilities Group PLC are given in the UUG annual report and financial statements.

Remuneration of key management personnel

	2017 £m	2016 £m
Salaries and short-term employee benefits	5.7	5.2
Post-employment benefits	0.1	0.1
Share-based payment charge	2.7	1.8
	8.5	7.1

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

Notes to financial statements

2. Directors and employees (continued)

Employee benefits expense (including directors)

Group	2017 £m	2016 £m
Wages and salaries	219.9	212.7
Social security	21.7	19.1
Severance	7.0	(0.2)
Post-employment benefits:		
Defined benefit pension expense (see note 17)	25.5	26.1
Defined contribution pension expense (see note 17)	11.2	9.9
	36.7	36.0
Charged to regulatory capital schemes	(129.4)	(120.7)
Amounts recharged to related parties at nil margin under transitional service agreements (see note A6)	(4.0)	-
Employee benefits expense	151.9	146.9

Within employee benefits expense were £10.1 million (2016: £0.9 million) of restructuring cost.

Options over shares of the ultimate parent undertaking, United Utilities Group PLC have been granted to employees of the group under various schemes. Details of the terms and conditions of each share option scheme are given in the 2017 UUG annual report and financial statements. Included within wages and salaries is an expense of £3.4 million (2016: £2.3 million) relating to a recharge of share-based payment costs from the ultimate parent undertaking.

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

Group	2017 number	2016 number
Average number of employees during the year	5,310	5,265

Company

The average number of employees during the year was 212 (2016: 211). These employees were engaged in the provision of services to United Utilities Water Limited, and as such employee costs of £16.2 million (2016: £15.4 million) in relation to these employees have been incurred directly by that company during the year.

Notes to financial statements

3. Operating profit

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

	2017 £m	2016 £m
Other operating costs		
Hired and contracted services	101.5	107.5
Property rates	91.6	86.3
Power	68.7	65.3
Materials	67.7	67.2
Charge for bad and doubtful receivables (see note 14)	29.9	39.2
Regulatory fees	28.6	27.9
Cost of properties disposed	8.6	10.5
Legal and professional expenses	6.5	5.8
Operating leases payable:		
Property	3.8	4.2
Plant and equipment	0.6	0.8
Loss on disposal of property, plant and equipment	3.3	5.4
Third party wholesale charges	3.0	15.1
Impairment of property, plant and equipment (see note 9)	0.2	11.4
Impairment of assets classified as held for sale	-	2.7
Amortisation of deferred grants and contributions (see note 20)	(6.7)	(6.9)
Compensation from insurers	(12.3)	(20.1)
Other expenses	40.1	63.5
	435.1	485.8
Other income		
Other income	(4.2)	(3.6)
	(4.2)	(3.6)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 9)	336.2	332.5
Amortisation of intangible assets (see note 10)	28.7	31.2
	364.9	363.7

As a result of two significant flooding incidents caused by storms Desmond and Eva in December 2015, there were £13.8 million (2016: £19.5 million) of expenses incurred, comprising £11.1 million (2016: £7.0 million) of operating costs, £2.5 million (2016: £1.1 million) of infrastructure renewals expenditure, and a £0.2 million (2016: £11.4 million) impairment of property, plant and equipment. Insurance compensation of £12.3 million (2016: £20.1 million) relating to the flooding incidents has been recognised and the group expects there to be further recovery of flooding incident costs under its insurance cover in the year ending 31 March 2018, as further remedial work is undertaken.

In addition, there were £5.8 million (2016: £11.1 million) of market reform restructuring costs incurred in preparing the business for competition in the non-household retail market and £nil (2016: £24.8 million) of costs relating to a large water quality incident, largely comprising customer compensation payments included within other expenses.

Total other operating costs are stated net of £14.5 million (2016: £nil) of costs recharged to Water Plus at nil margin under transitional service agreements.

Research and development expenditure for the year ended 31 March 2017 was £2.3 million (2016: £2.3 million).

Notes to financial statements

3. Operating profit (continued)

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

	2017 £000	Re-presented* 2016 £000
Audit services:		
Statutory audit - group and company	63	62
Statutory audit - subsidiaries	251	216
	314	278
Non-audit services:		
Regulatory audit services provided by the statutory auditor	53	45
Other non-audit services	201	288
	568	611

* Prior year comparatives in the above table have been re-presented to reflect the classification of services provided by the auditor that will be adopted prospectively in accordance with the group audit committee's policy in relation to this area, further details of which can be found within the corporate governance report on page 77 of 2017 UUG annual report and financial statement.

4. Investment income

	2017 £m	2016 £m
Interest receivable on short-term bank deposits held at amortised cost	0.9	1.9
Interest receivable on loan to joint ventures held at amortised cost (see note A6)	2.6	-
Net pension interest income (see note 17)	10.2	3.1
Interest receivable from ultimate parent undertaking (see note A6)	27.8	27.9
	41.5	32.9

Notes to financial statements

5. Finance expense

	2017 £m	2016 £m
Interest payable		
Interest payable on borrowings held at amortised cost(1)	227.0	198.1
	227.0	198.1
Fair value (gains)/losses on debt and derivative instruments(2)		
Fair value hedge relationships:		
Borrowings	70.4	60.8
Designated swaps	(81.4)	(62.2)
	(11.0)	(1.4)
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss(3)	37.5	4.3
Associated Swaps(4)	(30.1)	(23.5)
	7.4	(19.2)
Fixed interest rate swaps(4)	0.8	46.2
Electricity swaps(4)	(9.6)	14.2
Net receipts on swaps and debt under fair value option	(14.4)	(16.1)
Other swaps(4)(5)	(5.0)	(3.0)
Other	7.5	5.6
	(20.7)	46.9
Net fair value (gains)/losses on debt and derivative instruments(6)	(24.3)	26.3
	202.7	224.4

Notes:
(1) Includes a £80.7 million (2016: £37.9 million) non-cash inflation uplift expense in relation to the group's index-linked debt.
(2) Includes foreign exchange losses of £119.7 million (2016: £62.1 million), excluding those on instruments measured at fair value through profit or loss. These losses are largely offset by fair value gains on derivatives.
(3) Includes a £11.9 million loss (2016: £15.1 million gain) 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 intends 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 £15.4 million income (2016: £16.5 million) due to net interest on swaps and debt under fair value option.

Interest payable is stated net of £29.2 million (2016: £21.3 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. This has been calculated by applying a capitalisation rate of 3.0 per cent (2016: 2.7 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

Notes to financial statements

6. Tax

	2017 £m	2016 £m
Current tax		
UK corporation tax	59.5	58.8
Adjustments in respect of prior years	(22.5)	(9.0)
Total current tax charge for the year	37.0	49.8
Deferred tax		
Current year	28.2	18.6
Adjustments in respect of prior years	7.0	5.6
	35.2	24.2
Change in tax rate	(58.2)	(112.5)
Total deferred tax credit for the year	(23.0)	(88.3)
Total tax charge/(credit) for the year	14.0	(38.5)

The deferred tax credit of £58.2 million (2016: £112.5 million) reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020 (2016: 20 per cent to 18 per cent from 1 April 2020). The adjustments in respect of prior years relates to agreement with the tax authorities of prior years' UK tax matters; the current year figure also includes the release of a current tax provision in relation to agreed historic overseas tax matters.

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

	2017 £m	2017 %	2016 £m	2016 %
Profit before tax	470.2		381.4	
Tax at the UK corporation tax rate	94.0	20.0	76.2	20.0
Adjustments in respect of prior years	(15.5)	(3.3)	(3.4)	(0.9)
Change in tax rate	(58.2)	(12.4)	(112.5)	(29.5)
Net (income)/expense not taxable/other	(6.3)	(1.3)	1.2	0.3
Total tax charge/(credit) and effective tax rate for the year	14.0	3.0	(38.5)	(10.1)

Notes to financial statements

6. Tax (continued)

Tax on items taken directly to equity

Group	2017 £m	2016 £m
Current tax		
Relating to other pension movements	(9.8)	-
	(9.8)	-
Deferred tax (see note 18)		
On remeasurement (losses)/gains on defined benefit pension schemes	(13.8)	32.0
Relating to other pension movements	8.8	-
Change in tax rate	(2.5)	(5.5)
	(7.5)	26.5
Total tax (credit)/charge on items taken directly to equity	(17.3)	26.5

The deferred tax credit of £2.5 million (2016: £5.5 million) reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020 (2016: 20 per cent to 18 per cent from 1 April 2020).

Company	2017 £m	2016 £m
Current tax		
Relating to other pension movements	(2.2)	-
	(2.2)	-
Deferred tax (see note 18)		
On remeasurement gains on defined benefit pension schemes	(1.1)	7.1
Relating to other pension movements	2.0	-
Change in tax rate	(0.5)	(1.0)
	0.4	6.1
Total tax (credit)/charge on items taken directly to equity	(1.8)	6.1

7. Dividends

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

	2017 £m	2016 £m
Ordinary shares		
Interim dividend for the year ended 31 March 2017 at 19.82 pence per share (2015: 19.44 pence)	174.8	171.4
Interim dividend for the year ended 31 March 2017 at 10.01 pence per share (2016: 9.90 pence)	88.3	87.3
	263.1	258.7

Notes to financial statements

8. Disposal of non-household retail business

On 3 May 2016, the Competition and Markets Authority approved the formation of a joint venture, Water Plus Group Limited (Water Plus), between United Utilities PLC and Severn Trent PLC. On 1 June 2016, the group completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Water Plus. This resulted in a £22.1 million profit and £3.3 million of cash proceeds on disposal of the business, together with a £15.6 million disposal of assets that had been classified as held for sale. The formation of the joint venture resulted in an increase in interests in joint ventures of £39.1 million (see note 11), comprising £25.6 million of shares in the joint venture received on disposal of the non-household retail business, and £13.5 million of equity contributed during the year. The group's £2.0 million share of the joint venture's losses for the period was subsequently recognised, which included £5.2 million of initial set-up costs not expected to be incurred in future years.

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 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
Additions	6.7	80.1	107.0	10.5	513.6	717.9
Transfers	24.3	42.3	494.6	22.6	(583.8)	-
Disposals	(3.7)	-	(48.0)	(34.4)	-	(86.1)
At 31 March 2017	**354.2**	**5,243.1**	**7,033.2**	**496.8**	**942.3**	**14,069.6**
Accumulated depreciation						
At 1 April 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
Charge for the year	10.1	36.0	253.1	37.0	-	336.2
Impairment	-	-	0.2	-	-	0.2
Transfers	-	0.2	-	(0.2)	-	-
Disposals	(2.7)	-	(42.8)	(33.2)	-	(78.7)
At 31 March 2017	**111.6**	**345.9**	**2,870.7**	**335.9**	**-**	**3,664.1**
Net book value at 31 March 2016	222.7	4,811.0	3,819.4	165.8	1,012.5	10,031.4
Net book value at 31 March 2017	**242.6**	**4,897.2**	**4,162.5**	**160.9**	**942.3**	**10,405.5**

At 31 March 2017, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £335.2 million (2016: £439.0 million).

Notes to financial statements

9. Property, plant and equipment (continued)

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

Company

The company had no property, plant and equipment or contractual commitments for the acquisition of property, plant and equipment at 31 March 2017 or 31 March 2016.

10. Intangible assets

	Total
Group	£m
Cost	
At 1 April 2015	264.5
Additions	67.0
Disposals	-
Transfer to assets classified as held for sale	(20.6)
At 31 March 2016	310.9
Additions	54.5
Disposals	(8.2)
At 31 March 2017	357.2
Accumulated amortisation	
At 1 April 2015	119.6
Charge for the year	31.2
Transfer to assets classified as held for sale	(2.3)
At 31 March 2016	148.5
Charge for the year	28.7
Disposals	(7.7)
At 31 March 2017	169.5
Net book value at 31 March 2016	162.4
Net book value at 31 March 2017	187.7

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

At 31 March 2017, the group had entered into contractual commitments for the acquisition of intangible assets amounting to £1.7 million (2016: £8.3 million).

Company

The company had no intangible assets or contractual commitments for the acquisition of intangible assets at 31 March 2017 or 31 March 2016.

Notes to financial statements

11. Joint ventures

Group	Total £m
At 1 April 2015	31.7
Share of profits of joint ventures	5.0
Dividends received from joint ventures	(4.6)
Currency translation differences	3.0
At 31 March 2016	35.1
Additions	39.1
Share of profits of joint ventures	3.8
Dividends received from joint ventures	(5.4)
Currency translation differences	2.6
At 31 March 2017	75.2

During the year ended 31 March 2017, the group recognised a £39.1 million investment in Water Plus, a joint venture formed during the year between the group and Severn Trent PLC that is jointly owned and controlled by both parties under a joint venture agreement. Further details of the formation of Water Plus are disclosed in note 8.

The group's other interests in joint ventures mainly comprise its interest in AS Tallinna Vesi (Tallinn Water). Joint management of Tallinn Water is based on a shareholders' agreement.

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

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

Company

At 31 March 2017, the Company had investments in joint ventures of £39.1 million (2016: £nil), having recognised a £39.1 million investment in Water Plus during the year.

12. Investments

Group	Total £m
At 1 April 2015	8.6
Disposals	(0.2)
Currency translation differences	0.3
At 31 March 2016	8.7
Disposals	(0.9)
Currency translation differences	1.2
At 31 March 2017	9.0

During the year, the group reduced its investment in Muharraq Holding Company 1 Limited through a £0.9 million (2016: £0.2 million) repayment of a shareholder loan.

At 31 March 2017, the group's investments mainly comprised its investment in Muharraq Holding Company 1 Limited. These investments are held at fair value.

Notes to financial statements

12. Investments (continued)

Company	Shares in subsidiary undertakings £m
At 1 April 2015	4,940.1
Disposals	(729.3)
Impairment	(1.2)
At 31 March 2016	4,209.6
Disposals	(18.6)
Impairment	(9.8)
Net book value at 31 March 2017	4,181.2

During the year ended 31 March 2017, the company disposed of an £18.6 million investment in the ordinary shares of United Utilities BV, which resulted in a realisation of value of £12.8 million through a repayment of capital. Prior to this disposal, United Utilities BV paid the Company a dividend of £71.4 million. This company was subsequently liquidated.

In addition to this, impairments of £6.6 million and £3.2 million were made to the investments in United Utilities International Limited and United Utilities Utility Solutions (Industrial) Limited respectively due to decreases in the underlying assets of these companies.

Disposals of £729.3 million during the prior year ended 31 March 2016 comprised a £562.2 million investment in the ordinary shares of United Utilities (Investments) BV and £167.1 million investment in the ordinary shares of United Utilities BV, these resulted in realisations of value of £562.2million and £167.1 million respectively through repayments of capital. United Utilities (Investments) BV was subsequently liquidated.

An impairment of £1.2 million was made in the year ended 31 March 2016 to the investment in United Utilities International Limited due to a decrease in the underlying net assets of this company.

13. Inventories

Group	2017 £m	2016 £m
Properties held for resale	13.5	19.7
Other inventories	8.9	9.6
	22.4	29.3

Company

The company had no inventories at 31 March 2017 or 31 March 2016.

Notes to financial statements

14. Trade and other receivables

	Group		Company	
	2017	2016	2017	2016
	£m	£m	£m	£m
Trade receivables	124.7	175.1	0.2	0.1
Amounts owed by subsidiary undertakings	-	-	1,593.5	1,550.4
Amounts owed by ultimate parent undertaking (see note A6)	1674.1	1,646.4	1,674.1	1,646.4
Amounts owed by other related parties (see note A6)	163.5	2.9	19.2	-
Other debtors and prepayments	62.0	71.8	-	-
Accrued income	66.0	120.1	-	-
	2,090.3	2,016.3	3,287.0	3,196.9

At 31 March 2017 the group had £1,777.7 million (2016: £1,639.4 million) and the company had £1,674.4 million (2016: £1,636.9 million) of trade and other receivables classified as non-current. These included £1,665.4 million (2016: £1,636.9 million) relating to amounts owed by the ultimate parent undertaking and £9.0 million (2016: £nil) relating to amounts owed by other related parties.

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

The carrying amounts of trade and other receivables 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:

	2017	2016
Group	£m	£m
At the start of the year	94.4	100.5
Amounts charged to operating expenses (see note 3)	29.9	39.2
Trade receivables written off	(38.9)	(45.3)
At the end of the year	85.4	94.4

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

At 31 March 2017 and 31 March 2016, the group had no trade receivables that were past due and not individually impaired.

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

	2017	2016
Company	£m	£m
At the start of the year	89.7	91.7
Amounts charged/(credited) to operating expenses	1.1	(2.0)
Trade receivables written off	(1.4)	-
At the end of the year	89.4	89.7

Notes to financial statements

14. Trade and other receivables (continued)

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

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

Group	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
Trade receivables				
At 31 March 2017	79.9	32.0	5.0	116.9
At 31 March 2016	127.0	37.5	5.1	169.6

At 31 March 2017, the group had £7.8 million (2016: £5.5 million) of trade receivables that were not past due.

Company

At 31 March 2017 and 31 March 2016, the company had no trade receivables that were past due.

The carrying amount of trade and other receivables approximates to their fair value at 31 March 2017 and 31 March 2016.

15. Cash and cash equivalents

	Group 2017 £m	Group 2016 £m	Company 2017 £m	Company 2016 £m
Cash at bank and in hand	1.5	4.8	0.2	0.3
Short-term bank deposits	246.3	208.8	50.0	7.0
Cash and short-term deposits	247.8	213.6	50.2	7.3
Book overdrafts (included in borrowings, see note 16)	(26.9)	(31.0)	-	-
Cash and cash equivalents in the statement of cash flows	220.9	182.6	50.2	7.3

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

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

Notes to financial statements

16. Borrowings

Group	2017 £m	2016 £m
Non-current liabilities		
Bonds	4,851.0	4,439.2
Book and other term borrowings	2,207.4	2,069.6
	7,058.4	6,508.8
Current liabilities		
Bonds	37.3	-
Bank and other term borrowings	261.3	437.7
Book overdrafts (see note 15)	26.9	31.0
Amounts owed to ultimate parent undertaking	61.3	55.8
	386.8	524.5
	7,445.2	7,033.3

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

Company	2017 £m	2016 £m
Non-current liabilities		
Bonds	815.8	730.5
Current liabilities		
Bank and other term borrowings	135.1	73.6
Amounts owed to subsidiary undertakings	711.4	686.1
Amounts owed to ultimate parent undertaking	61.3	55.8
	907.8	815.5
	1,723.6	1,546.0

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

Notes to financial statements

17. Retirement benefit surplus

Defined benefit schemes

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

		Group		Company
	2017	2016	2017	2016
	£m	£m	£m	£m
Current service cost	19.7	22.3	1.4	1.6
Curtailments/settlements	3.1	1.1	0.3	0.2
Administrative expenses	2.7	2.7	0.9	1.0
Pension expense charged to operating profit	25.5	26.1	2.6	2.8
Net pension interest income credited to investment income (see note 4)	(10.2)	(3.1)	(1.8)	(0.4)
Net pension expense charged before tax	15.3	23.0	0.8	2.4

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £22.4 million (2016: £25.0 million) for the group and £2.3 million (2016: £2.6 million) for the company, comprising current service costs and administrative expenses.

Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £33.6 million (2016: £34.9 million) for the group and £2.3 million (2016: £2.6 million) for the company comprise the defined benefit costs described above of £22.4 million (2016: £25.0 million) for the group and £2.3 million (2016: £2.6 million) for the company, and defined contribution pension costs of £11.2 million (2016: £9.9 million) for the group (see note 2) and £nil (2016: £nil) for the company (see note 2).

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

		Group		Company
	2017	2016	2017	2016
	£m	£m	£m	£m
At the start of the year	275.2	79.2	48.3	4.4
Expense recognised in the income statement	(15.3)	(23.0)	(0.8)	(2.4)
Contributions paid	64.3	58.9	11.8	10.8
Remeasurement (losses)/gains gross of tax	(76.7)	160.1	(6.3)	35.5
At the end of the year	247.5	275.2	53.0	48.3

Included in the group contributions paid of £64.3 million (2016: £58.9 million) and company contributions paid of £11.8 million (2016: £10.8 million) were deficit repair contributions for the group of £43.0 million (2016: £33.3 million) and for the company of £10.2 million (2016: £8.5 million). No inflation funding mechanism payments were made during the year by either the group or the company (2016: £nil for the group and the company).

Notes to financial statements

17. Retirement benefit surplus (continued)

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

	Group		Company	
	2017	2016	2017	2016
	£m	£m	£m	£m
The return on plan assets, excluding amounts included in interest	555.5	56.0	138.6	7.7
Actuarial (losses)/gains arising from changes in financial assumptions	(721.4)	98.1	(182.9)	26.7
Actuarial gains/(losses) arising from changes in demographic assumptions	52.7	(46.6)	14.8	(11.8)
Actuarial gains arising from experience	36.5	52.6	23.2	12.9
Remeasurement (losses)/gains on defined benefit pension schemes	(76.7)	160.1	(6.3)	35.5

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 £11.2 million (2016: £9.9 million) of contributions and the company made £nil (2016: £nil) of contributions to defined contribution schemes which are included in employee benefit expense (see note 2).

18. Deferred tax liabilities

The following are the major deferred tax liabilities and assets recognised by the group and company, and the movements thereon, during the current and prior year:

Group	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2015	1,125.0	16.6	(17.8)	1,123.8
(Credited)/charged to the income statement (see note 6)	(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
(Credited)/charged to the income statement (see note 6)	(25.4)	-	2.4	(23.0)
Credited to equity (see note 6)	-	(7.5)	-	(7.5)
At 31 March 2017	1,011.4	42.1	(22.0)	1,031.5
Company				
At 1 April 2015	(0.1)	0.8	0.5	1.2
Charged/(credited) to the income statement	-	1.8	(1.1)	0.7
Charged to equity (see note 6)	-	6.1	-	6.1
At 31 March 2016	(0.1)	8.7	(0.6)	8.0
Charged to the income statement	-	-	0.2	0.2
Charged to equity (see note 6)	-	0.4	-	0.4
At 31 March 2017	(0.1)	9.1	(0.4)	8.6

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

Notes to financial statements

19. Provisions

Group	Severance £m	Other £m	Total £m
At 1 April 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
Charged to the income statement	7.0	11.0	18.0
Utilised in the year	(4.2)	(2.4)	(6.6)
At 31 March 2017	3.7	22.8	26.5

The group had no provisions classed as non-current at 31 March 2017 or 31 March 2016.

The severance provision as at 31 March 2017 and 31 March 2016 relates to severance costs as a result of group reorganisation.

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

Company

The company had no provisions at 31 March 2017 or 31 March 2016.

20. Trade and other payables

Group	2017 £m	2016 £m
Non-current		
Deferred grants and contributions	570.7	517.4
Other creditors	18.6	13.1
	589.3	530.5

Company

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

	Group 2017 £m	Group 2016 £m	Company 2017 £m	Company 2016 £m
Current				
Trade payables	35.2	44.1	-	-
Amounts owed to ultimate parent undertaking	7.8	6.7	5.6	5.5
Amounts owed to subsidiary undertakings	-	-	80.1	144.6
Amounts owed to other related parties	12.1	-	-	-
Other tax and social security	5.1	4.9	-	-
Deferred grants and contributions	8.5	9.0	-	-
Accruals and other creditors	220.9	239.5	13.4	11.7
Deferred income	39.5	42.6	-	-
	329.1	346.8	99.1	161.8

The average credit period taken for trade purchases for the group is 23 days (2016: 26 days) and for the company is nil days (2016: nil days).

Notes to financial statements

20. Trade and other payables (continued)

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

Deferred grants and contributions

	2017 £m	2016 £m
Group		
At the start of the year	526.4	485.8
Cash received during the year	29.0	17.3
Transfers of assets from customers	33.5	32.8
Credited to income statement – revenue	(3.0)	(2.6)
Credited to the income statement – other operating costs (see note 3)	(6.7)	(6.9)
At the end of the year	579.2	526.4

21. Share capital

	2017 number	2017 £	2016 number	2016 £
Group and Company				
Issued, called up and fully paid				
Ordinary shares of 100.0 pence each	881,787,478	881,787,478	881,787,478	881,787,478
Deferred A shares of 100.0 pence each	1	1	1	1
	881,787,479	881,787,479	881,787,479	881,787,479

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

22. Operating lease commitments

Group	Property 2017 £m	Plant and equipment 2017 £m	Property 2016 £m	Plant and equipment 2016 £m
Commitments under non-cancellable operating leases due				
Within one year	2.8	0.6	3.0	0.7
In the second to fifth years inclusive	10.2	0.4	10.4	0.5
After five years	277.9	-	278.6	-
	290.9	1.0	292.0	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.

Company	Property 2017 £m	Property 2016 £m
Commitments under non-cancellable operating leases due		
In the second to fifth years inclusive	0.1	0.1
After five years	0.1	0.1
	0.2	0.2

Notes to financial statements

23. Contingent liabilities

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP), though at this stage it is not possible to quantify the impact of legislative changes proposed by the UK Government in this area. See note A5 for further details.

Following a review undertaken during the year, the group and company have determined that the possibility of any outflow in respect of performance guarantees issued is remote and, as such, there are no contingent liabilities to be disclosed in respect of these for the group (2016: £9.8 million) or the company (2016: £5.1 million).

24. Events after the reporting period

There were no events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2017.

25. Ultimate parent undertaking

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

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

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

Notes to the financial statements – appendices

A1. Cash generated from operations

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit before tax	470.2	381.4	339.3	281.1
Adjustment for investment income (see note 4) and finance expense (see note 5)	161.2	191.5	(35.7)	(6.2)
Adjustment for profit on disposal of business (see note 8)	(22.1)	-	-	-
Adjustment for share of profits of joint ventures (see note 11)	(3.8)	(5.0)	-	-
Operating profit	605.5	567.9	303.6	274.9
Adjustments for:				
Depreciation of property, plant and equipment (see note 9)	336.2	332.5	-	-
Amortisation of intangible assets (see note 10)	28.7	31.2	-	-
Impairment of property, plant and equipment (see note 9)	0.2	11.4	-	-
Impairment of assets classified as available for sale	-	2.7	-	-
Loss on disposal of property, plant and equipment (see note 3)	3.3	5.4	-	-
Loss on disposal of intangible assets	0.5	-	-	-
Amortisation of deferred grants and contributions (see note 20)	(6.7)	(6.9)	-	-
Other non-cash movements	(3.0)	(3.8)	(8.6)	1.2
Changes in working capital:				
Decrease in inventories (see note 13)	6.9	11.2	-	-
Decrease/(increase) in trade and other receivables	42.6	(41.7)	(51.6)	2.6
(Decrease)/increase in trade and other payables	(5.1)	(9.9)	91.5	6.1
Increase in provisions (see note 19)	11.4	2.6	-	-
Pension contributions paid less pension expense charged to operating profit	(38.8)	(32.8)	(9.2)	(8.0)
Cash generated from operations	981.7	869.8	325.7	276.8

The group has received property, plant and equipment of £33.5 million (2016: £32.8 million) in exchange for the provision of future goods and services (see notes 20 and A7).

A2. Net Debt

Group	2017 £m	2016 £m
At the start of the year	6,315.8	5,977.8
Net capital expenditure	691.7	681.6
Dividends (see note 7)	263.1	258.7
Loans to joint ventures	109.0	-
Interest	127.6	139.2
Inflation uplift on index-linked debt (see note 5)	80.7	37.9
Tax	41.2	53.1
Other	1.9	(5.1)
Fair value movements*	(9.9)	42.4
Cash generated from operations (see note A1)	(981.7)	(869.8)
At the end of the year	6,639.4	6,315.8

* Fair value movements includes net fair value gains on debt and derivative instruments of £24.3 million (2016: £26.3 million losses), less £14.4 million (2016: £16.1 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:

Group	Currency	Year of final repayment	Fair value 2017 £m	Carrying value 2017 £m	Fair value 2016 £m	Carrying value 2016 £m
Borrowings in fair value hedge relationships			**2,544.6**	**2,522.4**	**2,293.0**	**2,373.0**
5.375% 150m bond	GBP	2018	164.3	156.8	169.6	162.5
4.55% 250m bond	USD	2018	208.1	204.7	183.9	185.6
5.375% 350m bond	USD	2019	295.3	294.8	263.2	269.3
4.25% 500m bond	EUR	2020	478.9	469.7	455.9	455.1
5.75% 375m bond	GBP	2022	455.4	429.3	449.5	434.5
5.625% 300m bond	GBP	2027	408.7	412.1	382.7	411.1
1.129% 52m bond	EUR	2027	43.5	43.6	38.4	41.0
5.02% JPY 10bn dual currency loan	JPY/USD	2029	97.7	105.8	81.4	96.1
2.058% 30m bond	EUR	2030	27.0	26.3	23.7	25.1
1.641% 30m bond	EUR	2031	25.7	24.6	-	-
2.9% 500m bond	HKD	2031	61.1	56.4	-	-
5.00% 200m bond	GBP	2035	278.9	298.3	244.7	292.7
Borrowings designated at fair value through profit or loss			**375.5**	**375.5**	**338.0**	**338.0**
6.875% 400m bond	USD	2028	375.5	375.5	338.0	338.0
Borrowings measured at amortised cost			**5,743.5**	**4,547.3**	**4,885.4**	**4,322.3**
1.97%+RPI 200m EIB IL loan	GBP	2016	-	-	269.9	267.4
Short-term bank borrowings - fixed	GBP	2017	202.0	202.0	127.5	127.5
1.30%+LIBOR 5bn bond	JPY	2017	36.3	37.3	31.7	32.0
2.46%+RPI 50m EIB IL loan	GBP	2020	69.3	60.8	65.7	59.3
2.10%+RPI 50m EIB IL loan	GBP	2020	68.5	60.8	64.7	59.3
1.93%+RPI 50m EIB IL loan	GBP	2020	68.2	60.9	64.5	59.4
1.90%+RPI 50m EIB IL loan	GBP	2020	68.2	61.0	64.5	59.5
1.88%+RPI 50m EIB IL loan	GBP	2020	68.1	60.9	64.2	59.3
1.84%+RPI 50m EIB IL loan	GBP	2020	68.2	61.1	64.4	59.6
1.73%+RPI 50m EIB IL loan	GBP	2020	68.0	61.2	64.2	59.6
1.61%+RPI 50m EIB IL loan	GBP	2020	67.8	61.2	63.9	59.7
0.80%+LIBOR 100m loan	GBP	2022	102.6	100.0	98.3	100.0
0.47%+RPI 100m IL loan	GBP	2023	116.5	107.9	105.0	105.2
0.49%+RPI 100m IL loan	GBP	2025	115.6	103.8	101.1	101.2
0.013%+RPI 25m IL bond	GBP	2025	28.1	25.9	24.2	25.2
0.1275%+RPI 100m IL loan	GBP	2026	112.3	102.4	96.4	100.0
0.01%+RPI 20m IL loan	GBP	2028	22.0	22.3	-	-
1.29%+RPI 50m EIB (amortising) IL loan	GBP	2029	57.4	51.5	58.6	54.2
1.23%+RPI 50m EIB (amortising) IL loan	GBP	2029	55.1	49.7	54.6	52.5
1.12%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.5	51.0	57.6	53.7
1.10%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.3	51.0	57.4	53.7
0.75%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.5	51.9	55.2	54.4
1.15%+RPI 50m EIB (amortising) IL loan	GBP	2030	57.5	51.5	56.2	54.1
1.11%+RPI 50m EIB (amortising) IL loan	GBP	2030	57.6	51.7	56.2	54.2
0.76%+RPI 50m EIB (amortising) IL loan	GBP	2030	56.4	51.7	55.0	54.3
0.178%+RPI 35m IL bond	GBP	2030	40.2	36.2	33.6	35.3

Notes to the financial statements – appendices

A3. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2017 £m	Carrying value 2017 £m	Fair value 2016 £m	Carrying value 2016 £m
Borrowings measured at amortised cost (continued)						
0.245%+CPI 20m IL bond	GBP	2031	20.2	20.0	-	-
0.01%+RPI 38m IL bond	GBP	2031	42.2	41.3	-	-
3.375%+RPI 50m IL bond	GBP	2032	124.1	74.2	107.6	72.8
0.709%+LIBOR 100m EIB (amortising) loan	GBP	2032	94.9	93.8	95.6	100.0
0.691%+LIBOR 150m EIB (amortising) loan	GBP	2032	146.4	145.3	142.9	150.0
0.573%+LIBOR 100m EIB (amortising) loan	GBP	2033	100.2	100.0	93.7	100.0
0.511%+LIBOR 150m EIB (amortising) loan	GBP	2033	149.6	150.0	140.0	150.0
0.01%+RPI 100m EIB (amortising) IL loan	GBP	2033	107.9	102.3	94.7	99.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.9	76.7	71.1	74.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.7	76.2	-	-
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.7	76.2	-	-
1.9799%+RPI 100m IL bond	GBP	2035	212.4	138.9	171.4	136.4
0.379%+CPI 20m IL bond	GBP	2036	20.9	20.0	-	-
0.01%+RPI 26.5m IL bond	GBP	2036	30.3	31.0	-	-
0.01%+RPI 29m IL bond	GBP	2036	32.2	31.5	-	-
1.66%+RPI 35m IL bond	GBP	2037	62.7	44.7	51.6	43.6
0.093%+CPI 60m IL bond	GBP	2037	59.0	59.6	-	-
2.40%+RPI 70m IL bond	GBP	2039	132.2	87.2	113.5	85.0
1.7829%+RPI 100m IL bond	GBP	2040	207.5	137.5	172.8	135.0
1.3258%+RPI 50m IL bond	GBP	2041	95.7	68.6	78.9	67.3
1.5802%+RPI 100m IL bond	GBP	2042	202.6	137.0	166.6	134.5
1.5366%+RPI 50m IL bond	GBP	2043	102.4	68.4	82.5	67.1
1.397%+RPI 50m IL bond	GBP	2046	102.9	68.5	81.8	67.3
1.7937%+RPI 50m IL bond	GBP	2049	118.0	68.2	91.1	67.0
Commission for New Towns (amortising) loan - fixed	GBP	2053	56.1	28.4	52.5	28.7
1.847%+RPI 100m IL bond	GBP	2056	224.1	135.0	180.8	131.6
1.815%+RPI 100m IL bond	GBP	2056	221.5	134.4	179.4	131.0
1.662%+RPI 100m IL bond	GBP	2056	218.2	134.2	173.1	130.8
1.591%+RPI 25m IL bond	GBP	2056	52.5	33.4	42.4	32.6
1.5865%+RPI 50m IL bond	GBP	2056	105.8	67.0	85.6	65.3
1.556%+RPI 50m IL bond	GBP	2056	105.3	66.7	84.5	65.0
1.435%+RPI 50m IL bond	GBP	2056	102.5	66.5	82.0	64.8
1.3805%+RPI 35m IL bond	GBP	2056	71.0	46.5	56.7	45.3
1.702%+RPI 50m IL bond	GBP	2057	107.9	65.1	86.1	63.5
1.585%+RPI 100m IL bond	GBP	2057	208.6	129.1	165.1	125.9
Amounts owed to ultimate parent undertaking	GBP	2017	61.3	61.3	55.8	55.8
Book overdrafts (see note 15)	GBP	2017	26.9	26.9	31.0	31.0
			8,663.6	**7,445.2**	**7,516.4**	**7,033.3**

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

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

Notes to the financial statements – appendices

A3. Borrowings (continued)

Terms and debt repayment schedule

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

Company	Currency	Year of final repayment	Fair value 2017 £m	Carrying value 2017 £m	Fair value 2016 £m	Carrying value 2016 £m
Borrowings in fair value hedge relationships			**503.4**	**499.5**	**447.1**	**454.9**
4.55% 250m bond	USD	2018	208.1	204.7	183.9	185.6
5.375% 350m bond	USD	2019	295.3	294.8	263.2	269.3
Borrowings measured at amortised cost			**1,283.3**	**1,224.1**	**1,153.5**	**1,091.1**
Short-term bank borrowings – fixed	GBP	2017	135.1	135.1	73.6	73.6
Amounts owed to subsidiary undertakings	GBP	2017	711.4	711.4	686.1	686.1
Amounts owed to ultimate parent undertaking	GBP	2017	61.3	61.3	55.8	55.8
6.875% 400m bond	USD	2028	375.5	316.3	338.0	275.6
			1,786.7	**1,723.6**	**1,600.6**	**1,546.0**

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

Notes to the financial statements – appendices

A4. Financial risk management

Risk management

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

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

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

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

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

Liquidity risk

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

At 31 March 2017, the group had £1,147.8 million (2016: £888.6 million) of available liquidity, which comprised £247.8 million (2016: £213.6 million) cash and short-term deposits, £725.0 million (2016: £600.0 million) of undrawn committed borrowing facilities, and £175.0 million (2016: £75.0 million) of undrawn term loan facilities. Short-term deposits mature within three months.

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

		Group		Company
	2017	2016	2017	2016
	£m	£m	£m	£m
Expiring within one year	150.0	150.0	20.0	35.0
Expiring after one year but in less than two years	100.0	150.0	20.0	20.0
Expiring after more than two years	500.0	300.0	185.0	60.0
	750.0	600.0	225.0	115.0
Facilities drawn[1]	(25.0)	-	(25.0)	-
Undrawn borrowings facilities	725.0	600.0	200.0	115.0

Note:

(1) Facilities expiring after more than two years.

These facilities are arranged on a bilateral rather than a syndicated basis, which spreads the maturities more evenly over a longer time period, thereby reducing the refinancing risk by providing several renewal points rather than a large single refinancing point.

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Maturity analysis

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

Group	Total[(1)] £m	Adjust-ment[(2)] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2017								
Bonds	9,926.5	-	191.9	771.4	563.2	107.2	482.9	7,809.9
Bank and other term borrowings	3,060.8	-	317.9	110.9	117.8	663.4	111.6	1,739.2
Amounts owed to ultimate parent undertaking	61.3	-	61.3	-	-	-	-	-
Adjustment to carrying value[(2)]	(5,603.4)	(5,603.4)	-	-	-	-	-	-
Borrowings	7,445.2	(5,603.4)	571.1	882.3	681.0	770.6	594.5	9,549.1
Derivatives:								
Payable	1,292.1	-	143.3	397.8	491.2	33.3	25.0	201.5
Receivable	(1,855.3)	-	(245.5)	(807.9)	(518.7)	(10.7)	(10.6)	(261.9)
Adjustment to carrying value[(2)]	5.2	5.2	-	-	-	-	-	-
Derivatives – net assets	(558.0)	5.2	(102.2)	(410.1)	(27.5)	22.6	14.4	(60.4)

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

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Maturity analysis (continued)

Notes:
(1) Forecast future cash flows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are therefore susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be three per cent and CPI will be two per cent over the life of each instrument.
(2) The carrying value of debt is calculated following various methods in accordance with 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	Total(1) £m	Adjust-ment(2) £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2017								
Bonds	1,020.2	-	45.7	510.6	21.2	20.9	20.6	401.2
Bank and other term borrowings	135.2	-	135.2	-	-	-	-	-
Amounts owed to ultimate parent undertaking	61.3	-	61.3	-	-	-	-	-
Amounts owed to subsidiary undertakings	711.4	-	711.4	-	-	-	-	-
Adjustment to carrying value(2)	(204.5)	(204.5)	-	-	-	-	-	-
Borrowings	1,723.6	(204.5)	953.6	510.6	21.2	20.9	20.6	401.2
Derivatives:								
Payable	363.3	-	42.3	321.0	-	-	-	-
Receivable	(553.1)	-	(64.0)	(489.1)	-	-	-	-
Adjustment to carrying value(2)	2.5	2.5	-	-	-	-	-	-
Derivatives – net assets	(187.3)	2.5	(21.7)	(168.1)	-	-	-	-

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

Notes:

(1) Forecast future cash flows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are therefore susceptible to changes in market conditions.
(2) The carrying value of debt is calculated following various methods in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

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

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the majority of the group's customer base consisting of a large number of unrelated households. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings.

Following the sale of the group's non-household business on 1 June 2016 and the non-household retail market opening to competition, credit risk in this area is now concentrated to a small number of retailers to whom the group provides wholesale water and wastewater services. Retailers are licensed and monitored by Ofwat and as part of the regulations they must demonstrate that they have adequate resources available to supply services. The group's retail customers are on 30 day credit terms in respect of trading transactions. As at 31 March 2017, Water Plus was the group's single largest debtor, with amounts outstanding in relation to wholesale services of £40.8 million (2016: £nil). During the year, sales to Water Plus in relation to wholesale services were £402.7 million (2016: £nil). Details of transactions with Water Plus can be found in note A6.

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

The group manages its 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 2017 and 31 March 2016, 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	
	2017	2016	2017	2016
	£m	£m	£m	£m
Cash and short-term deposits (see note 15)	247.8	213.6	50.2	7.3
Trade and other receivables (see note 14)	2,090.3	2,016.3	3,287.0	3,196.9
Investments (see note 12)	9.0	8.7	-	-
Derivative financial instruments	807.7	765.6	237.2	141.4
	3,154.8	3,004.2	3,574.4	3,345.6

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Credit risk (continued)

Included within trade and other receivables for the group are amounts owed by the ultimate parent undertaking of £1,674.1 million (2016: £1,646.4 million), and £122.0 million of amounts owed by joint ventures in respect of borrowings, further details of which can be found in note A6.

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2017 the group held £176.9 million (2016: £127.5 million) and the company held £110.1 million (2016: £73.6 million) as collateral in relation to derivative financial instruments (included within borrowings in note A3).

Market risk

The group's exposure to market risk primarily results from its financing arrangements and the economic return which it is allowed on the regulatory capital value (RCV).

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

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 that 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 unexpected RCV movements caused by inflation.

Ofwat has indicated that from April 2020 the inflation return as an uplift to RCV will still comprise an element that will be linked to RPI; however, this will commence transition towards CPI. As a result, the group will identify opportunities to amend the economic hedge currently in place which can be evidenced by the issuing of £100.0 million of CPI indexed-linked debt during the year. 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 £3,602.3 million at 31 March 2017 (2016: £3,447.3 million).

Sensitivity analysis

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

Group	2017 £m	2016 £m
Increase/(decrease) in profit before tax and equity		
1 per cent increase in RPI/CPI	(36.4)	(35.0)
1 per cent decrease in RPI/CPI	36.4	35.0

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Sensitivity analysis (continued)

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

Company

The company had no material exposure to inflation risk at 31 March 2017 or 31 March 2016.

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 10 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**
	2017	2016	2017	2016
	£m	£m	£m	£m
Increase/(decrease) in profit before tax and equity				
1 per cent increase in interest rate	155.1	175.1	(11.8)	(11.3)
1 per cent decrease in interest rate	(153.0)	(182.5)	12.2	11.3

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

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

Notes to the financial statements – appendices

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.

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

Group	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2017							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,522.4	-	656.3	469.7	-	429.3	967.1
Effect of swaps	-	2,522.4	(656.3)	(469.7)	-	(429.3)	(967.1)
	2,522.4	2,522.4	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	375.5	-	-	-	-	-	375.5
Effect of swaps	-	375.5	-	-	-	-	(375.5)
	375.5	375.5	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	230.4	202.5	0.5	0.6	0.6	0.7	25.5
Floating rate instruments	653.3	653.3	-	-	-	-	-
Index-linked instruments	3,602.3	3,602.3	-	-	-	-	-
	4,486.0	4,458.1	0.5	0.6	0.6	0.7	25.5
Effect of fixed interest rate swaps	-	(3,131.3)	(50.0)	1,127.1	325.0	-	1,729.2
Total external borrowings	7,383.9	4,224.7	(49.5)	1,127.7	325.6	0.7	1,754.7
Amounts owed to ultimate parent undertaking	61.3	61.3	-	-	-	-	-
Total borrowings	7,445.2	4,286.0	(49.5)	1,127.7	325.6	0.7	1,754.7
Cash and short-term deposits	(247.8)	(247.8)	-	-	-	-	-
Net borrowings	7,197.4	4,038.2	(49.5)	1,127.7	325.6	0.7	1,754.7

Group	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2016							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,373.0	-	-	617.4	455.1	-	1,300.5
Effect of swaps	-	2,373.0	-	(617.4)	(455.1)	-	(1,300.5)
	2,373.0	2,373.0	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	338.0	-	-	-	-	-	338.0
Effect of swaps	-	338.0	-	-	-	-	(338.0)
	338.0	338.0	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	156.2	127.7	0.5	0.5	0.6	0.6	26.3
Floating rate instruments	663.0	663.0	-	-	-	-	-
Index-linked instruments	3,447.3	3,447.3	-	-	-	-	-
	4,266.5	4,238.0	0.5	0.5	0.6	0.6	26.3

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Repricing analysis (continued)

Group (continued)	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
Effect of fixed interest rate swaps	-	(3,006.3)	(125.0)	(50.0)	1,127.1	325.0	1,729.2
Total external borrowings	6,977.5	3,942.7	(124.5)	(49.5)	1,127.7	325.6	1,755.5
Amounts owed to ultimate parent undertaking	55.8	55.8	-	-	-	-	-
Total borrowings	7,033.3	3,998.5	(124.5)	(49.5)	1,127.7	325.6	1,755.5
Cash and short-term deposits	(213.6)	(213.6)	-	-	-	-	-
Net borrowings	6,819.7	3,784.9	(124.5)	(49.5)	1,127.7	325.6	1,755.5

Company	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2017							
Borrowings in fair value hedge relationships							
Fixed rate instruments	499.5	-	499.5	-	-	-	-
Effect of swaps	-	499.5	(499.5)	-	-	-	-
	499.5	499.5	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	451.4	135.1	-	-	-	-	316.3
	451.4	135.1	-	-	-	-	316.3
Total external borrowings	950.9	634.6	-	-	-	-	316.3
Amounts owed to subsidiary undertakings	711.4	711.4	-	-	-	-	-
Amounts owed to ultimate parent undertaking	61.3	61.3	-	-	-	-	-
Total borrowings	1,723.6	1,407.3	-	-	-	-	316.3
Cash and short-term deposits	(50.2)	(50.2)	-	-	-	-	-
Net borrowings	1,673.4	1,357.1	-	-	-	-	316.3

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Repricing analysis (continued)

Company	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2016							
Borrowings in fair value hedge relationships							
Fixed rate instruments	454.9	-	-	454.9	-	-	-
Effect of swaps	-	454.9	-	(454.9)	-	-	-
	454.9	454.9	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	349.2	73.6	-	-	-	-	275.6
	349.2	73.6	-	-	-	-	275.6
Total external borrowings	804.1	528.5	-	-	-	-	275.6
Amounts owed to subsidiary undertakings	686.1	686.1	-	-	-	-	-
Amounts owed to ultimate parent undertaking	55.8	55.8	-	-	-	-	-
Total borrowings	1,546.0	1,270.4	-	-	-	-	275.6
Cash and short-term deposits	(7.3)	(7.3)	-	-	-	-	-
Net borrowings	1,538.7	1,263.1	-	-	-	-	275.6

Electricity price risk

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

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

Sensitivity analysis

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

Group	2017 £m	2016 £m
Increase/(decrease) in profit before tax and equity		
20 per cent increase in electricity commodity prices	9.8	7.7
20 per cent decrease in electricity commodity prices	(9.8)	(7.7)

The company has no exposure to electricity price risk.

Currency risk

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

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Currency risk (continued)

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

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

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

Capital risk management

The group's objective when managing capital is to maintain efficient access to debt capital markets throughout the economic cycle. The board therefore believes that it is appropriate to maintain gearing, measured as group consolidated net debt (including derivatives) to regulatory capital value (RCV) of United Utilities Water Limited (UUW), within a target range of 55 per cent to 65 per cent. As at 31 March 2017, group consolidated gearing was 61 per cent (2016: 61 per cent), which is comfortably within this range.

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

In order to maintain existing credit ratings, the group needs to manage its capital structure with reference to the ratings methodology and measures used by Moody's and Standard & Poor's. The ratings methodology is normally based on a number of key ratios (such as RCV gearing, adjusted interest cover and Funds from Operations (FFO) to debt) and threshold levels as updated and published from time to time by Moody's and Standard & Poor's. The group looks to manage its risk by maintaining the relevant key financial ratios used by the credit rating agencies to determine a corporate's credit rating, within the thresholds approved by the UUG board. Capital risk is reported monthly to the treasury committee through the operational compliance report.

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

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 **2017**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	-	9.0	-	9.0
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	591.1	-	591.1
Derivative financial assets – held for trading[1]	-	216.6	-	216.6
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – held for trading[1]	-	(249.7)	-	(249.7)
Financial liabilities designated as fair value through profit or loss	-	(375.5)	-	(375.5)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(1,766.1)	(778.5)	-	(2,544.6)
Other financial liabilities at amortised cost	(937.9)	(4,744.9)	-	(5,682.8)
	(2,704.0)	(5,331.9)	-	(8.035.9)

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

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)	(3,575.5)	-	(4,885.4)
	(3,459.4)	(3,544.4)	-	(7,003.8)

Note:

(1) These derivatives form economic hedges and, as such, management intends to hold these through to maturity. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £215.7 million (2016: £177.2 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).

Company **2017**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	187.0	-	187.0
Derivative financial assets – held for trading(1) (2)	-	0.3	-	0.3
Financial liabilities at fair value through profit or loss				
Derivative financial assets – held for trading(1)	-	-	-	-
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(503.4)	-	-	(503.4)
Other financial liabilities at amortised cost	-	(1,283.3)	-	(1,283.3)
	(503.4)	(1,096.0)	-	(1,599.4)

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

Company **2016**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	141.4	-	141.4
Derivative financial assets – held for trading[1] [2]	-	-	-	-
Financial liabilities at fair value through profit or loss				
Derivative financial assets – held for trading[1]	-	(0.7)	-	(0.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(447.1)	-	-	(447.1)
Other financial liabilities at amortised cost	-	(1,153.5)	-	(1,153.5)
	(447.1)	(1,012.8)	-	(1,459.9)

Notes:

(1) These derivatives form economic hedges and, as such, management intends to hold these through to maturity.
(2) Includes amounts owed by subsidiary undertakings of £0.3 million (2016: £nil).

The group and company have calculated fair values using quoted prices where an active market exists, which has resulted in £2,704.0 million (2016: £3,459.4 million) for the group and £503.4 million (2016: £447.1 million) for the company of 'level 1' fair value measurements. In the absence of an appropriate quoted price, the group and company have applied discounted cash flow valuation models utilising market available data in line with prior years. In the group, the £755.4 million reduction (2016: £1,213.5 million reduction) in 'level 1' fair value measurements is largely due to a decrease in the number of observable quoted bond prices in active markets at 31 March 2017.

During the year, the fair value of financial liabilities designated at fair value through profit or loss resulted in a £37.5 million loss (2016: £4.3 million). Included within this was an £11.9 million loss (2016: £15.1 million gain) attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £62.2 million profit (2016: £74.1 million). The carrying amount is £173.4 million (2016: £135.9 million) higher than the amount contracted to settle on maturity.

Notes to the financial statements – appendices

A5. Retirement benefits

Defined benefit schemes

The group participates in two major funded defined benefit pension schemes in the United Kingdom – the United Utilities Pension Scheme (UUPS) and the United Utilities PLC group of the Electricity Supply Pension Scheme (ESPS), both of which are closed to new employees. The assets of these schemes are held in trust funds independent of the group's finances.

The trustees are composed of representatives of both the employer and employees. The trustees are required by law to act in the interests of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day-to-day administration of the benefits.

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		Company	
	2017	2016	2017	2016
	£m	£m	£m	£m
Total value of current employees benefits	917.5	831.6	63.9	68.5
Deferred members benefits	798.9	624.1	340.8	285.4
Pensioner members benefits	1,899.1	1,514.7	528.6	432.8
Total defined benefit obligation	3,615.5	2,970.4	933.3	786.7

The duration of the combined schemes is around 21 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 finalised funding valuations of the schemes were carried out by independent qualified actuaries as at 31 March 2013 (UUPS) and 31 March 2016 (ESPS) and determined that the schemes were both in a deficit position on a funding basis. The basis on which scheme liabilities are valued for funding purposes differs from the basis required under IAS 19, with liabilities on a funding basis being subject to assumptions at the valuation date that are not updated between revaluations. Funding deficits vary significantly from company to company but neither the deficits, the assumptions on which they are based, the associated sensitivities, nor the risk exposures are disclosed by many companies and therefore meaningful cross-company comparisons are not possible. Conversely, scheme liabilities are valued on a consistent basis between companies under IAS 19 and are subject to assumptions and sensitivities that are required to be disclosed. Consequently, the relative economic positions of companies are only comparable on an IAS 19 basis, subject to normalisation of assumptions used between companies.

A retirement benefit surplus was recognised as an asset at both 31 March 2017 and 31 March 2016 as, under both the UUPS and ESPS scheme rules, the group has an unconditional right to a refund of the surplus assuming the full settlement of the plans' liabilities in a single event, such as a scheme wind-up.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Funding requirements (continued)

Under UK legislation there is a requirement that pension schemes are funded prudently, and that funding plans are agreed by pension scheme trustees. The group has plans in place with the schemes' trustees to address the funding deficits by 31 December 2020 for the UUPS and 30 September 2024 for the ESPS, through a series of 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. Further details of the derivatives used in reducing investment risk are disclosed in the 'Further reporting analysis' section of this appendix.

In addition, the group has had an Inflation Funding Mechanism (IFM) in place since 2010 for the UUPS, which was extended to the ESPS in 2013. Under the IFM, additional contributions may be payable annually, calculated with reference to a notional amount of liabilities and the difference between outturn inflation and a fixed inflation assumption, currently set at 3.0 per cent per annum. To the extent that outturn inflation exceeds the fixed inflation assumption, additional contributions are payable in the following year and the base on which future payments are calculated increases resulting in the smoothing of inflation effects over future years. If outturn inflation is less than the fixed inflation assumption, no additional contributions are payable. The IFM does not have an accounting impact except to the extent that resulting cash contributions increase the level of scheme assets.

The group expects to make contributions of £62.5 million in the year ending 31 March 2018, comprising £38.9 million to the UUPS and £4.1 million to the ESPS in respect of deficit repair contributions, £18.2 million and £0.7 million in respect of regular contributions to UUPS and ESPS respectively, and £0.6 million in respect of expenses to the ESPS; no additional contributions are expected to be made under the IFM.

The company expects to make contributions of £11.8 million in the year ending 31 March 2018, comprising £6.8 million to UUPS and £3.4 million to ESPS in respect of deficit repair contributions, £1.0 million and £0.3 million in respect of regular contributions to UUPS and ESPS respectively, and £0.3 million in respect of expenses to ESPS; no additional contributions are expected to be made under the IFM.

The schemes' funding plans are reviewed every three years. The UUPS funding valuation at 31 March 2016 is currently ongoing and the next funding valuation for the ESPS is due no later than 31 March 2019.

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 a high quality corporate bond rate, which comprises an underlying interest rate and a credit spread.

The group has de-risked its pension schemes through hedging strategies applied to the underlying interest rate and the forecast RPI. 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 contributions, and through external market hedges.

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, at the current time, not to hedge this exposure due to its lower volatility in the short-term and the relatively high hedging costs.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Impact of scheme risk management on IAS 19 disclosures (continued)

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 2017, the discount rate has fallen by 0.85 per cent, which includes a 0.6 per cent decrease in credit spreads and a 0.25 per cent decrease in swap yields over the year. The IAS 19 remeasurement loss of £76.7 million for the group and £6.3 million for the company, reported in note 17, has largely resulted from the impact of the decrease in credit spreads during the year, partially offset by growth asset gains, the reduction in swap yields and the favourable impact of changes in mortality during the year.

Reporting and assumptions

The results of the latest funding valuations at 31 March 2016 for ESPS, and 31 March 2013 for UUPS, have been adjusted for IAS 19 in order to assess the position at 31 March 2017, by taking account of experience over the period, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service costs, were measured using the projected unit credit method.

Member data used in arriving at the liability figure included within the overall IAS 19 surplus has been based on the finalised actuarial valuation as at 31 March 2016 for ESPS and the preliminary results of the actuarial valuation as at 31 March 2016 for UUPS.

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:

	2017	2016
Group and Company	% p.a.	% p.a.
Discount rate	2.55	3.40
Pensionable salary growth and pension increases	3.40	3.20
Price inflation	3.40	3.20

Demographic assumptions

Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S2PA (2016: S1NA) year of birth tables, with scaling factor of 108 per cent for males and 102 per cent for females (2016: one-year age rating for males in the UUPS only), reflecting actual mortality experience; and CMI 2015 (2016: CMI 2014) long-term improvement factors, with a long-term annual rate of improvement of 1.75 per cent (2016: 1.75 per cent). The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

	2017	2016
Group and Company	years	years
Retired member - male	27.0	27.1
Non-retired member - male	29.0	29.2
Retired member - female	29.8	30.7
Non-retired member - female	31.9	32.9

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

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 £74.8 million (2016: £58.4 million) decrease/increase in the schemes’ liabilities for the group, and a £19.3 million (2016: £15.5 million) decrease/increase in the schemes’ liabilities for the company, at 31 March 2017, although as long as credit spreads remain stable this will be largely offset by an increase in the value of the schemes’ bond holdings and other instruments designed to hedge this exposure. The discount rate is based on high quality corporate bond yields of a similar duration to the schemes’ liabilities.

- ***Price inflation***

  An increase/decrease in the inflation assumption of 0.1 per cent would have resulted in a £70.0 million (2016: £55.3 million) increase/decrease in the schemes’ liabilities for the group, and an £18.1 million (2016: £14.6 million) increase/decrease in the schemes’ liabilities for the company, at 31 March 2017, as a significant proportion of the schemes’ benefit obligations are linked to inflation. However, around half of the schemes' liabilities were hedged for RPI in the external market at 31 March 2017, meaning that this sensitivity is likely to be halved as a result. In addition, around half of the schemes' liabilities were hedged through the IFM, with any change in inflation out-turn resulting in a change to cash contributions provided under this mechanism. Any change in inflation out-turn results in a change to the cash contributions provided under the IFM. As assumptions for pensionable salary growth and pension increases are in line with those for price inflation, sensitivities are also in line.

- ***Life expectancy***

  An increase/decrease in life expectancy of one year would have resulted in a £135.3 million (2016: £92.5 million) increase/decrease in the schemes’ liabilities for the group, and a £34.9 million (2016: £24.5 million) increase/decrease in schemes’ liabilities for the company, at 31 March 2017. 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.

Notes to the financial statements – appendices

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 %	2017 £m	Schemes' assets %	2016 £m
Equities	9.1	350.4	9.8	318.3
Other non-equity growth assets	4.8	185.6	9.4	304.3
Gilts	44.8	1,729.3	36.9	1,196.2
Bonds	39.8	1,537.3	41.0	1,332.7
Other	1.5	60.4	2.9	94.1
Total fair value of schemes' assets	100.0	3,863.0	100.0	3,245.6
Present value of defined benefit obligations		(3,615.5)		(2,970.4)
Net retirement benefit surplus		247.5		275.2

Company	Schemes' assets %	2017 £m	Schemes' assets %	2016 £m
Equities	6.1	60.3	9.8	81.6
Other non-equity growth assets	4.8	47.5	9.4	78.1
Gilts	30.2	297.4	24.6	205.8
Bonds	42.0	414.2	42.7	356.8
Other	16.9	166.9	13.5	112.7
Total fair value of schemes' assets	100.0	986.3	100.0	835.0
Present value of defined benefit obligations		(933.3)		(786.7)
Net retirement benefit surplus		53.0		48.3

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.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

The fair value derivatives included within pension scheme asset classification are analysed as follows:

			Group			Company
At 31 March 2017	Underlying assets	Fair value of Derivatives	Combined	Underlying assets	Fair value of Derivatives	Combined
	£m	£m	£m	£m	£m	£m
Equities	320.6	29.8	350.4	55.2	5.1	60.3
Other non-equity growth assets	185.6	-	185.6	47.5	-	47.5
Gilts	1,729.3	-	1,729.3	297.4	-	297.4
Bonds	1,547.6	(10.3)	1,537.3	416.0	(1.8)	414.2
Other	250.5	(190.1)	60.4	174.4	(7.5)	166.9
Total fair value of schemes' assets	4,033.6	(170.6)	3,863.0	990.5	(4.2)	986.3

			Group			Company
At 31 March 2016	Underlying assets	Fair value of Derivatives	Combined	Underlying assets	Fair value of Derivatives	Combined
	£m	£m	£m	£m	£m	£m
Equities	317.1	1.2	318.3	81.4	0.2	81.6
Other non-equity growth assets	304.3	-	304.3	78.1	-	78.1
Gilts	1,196.2	-	1,196.2	205.8	-	205.8
Bonds	1,347.2	(14.5)	1,332.7	359.3	(2.5)	356.8
Other	53.5	40.6	94.1	72.6	40.1	112.7
Total fair value of schemes' assets	3,218.3	27.3	3,245.6	797.2	37.8	835.0

The derivative values in the tables above represent the net market value of derivatives held within each of these asset categories as follows:

- Derivatives are held within the UUPS equity portfolio to gain economic exposure equivalent to around 4.0 per cent of that scheme's assets, and comprises total return swaps on equity indices with a value of £18.2 million (2016: £1.0 million) for the group and £3.1 million (2016: £0.2 million) for the company and currency forwards with a value of £11.6 million (2016: £0.2 million) for the group and £2.0 million (2016: £nil) for the company;

- Derivatives are used within the UUPS bond portfolio to hedge non-sterling exposure back to sterling, and comprises credit default swaps with a value of £(10.3) million (2016: £0.4 million) for the group and £(1.8) million (2016: £nil) for the company, interest rate swaps with a value of £nil (2016: £(15.4)million) for the group and £nil (2016: £(2.6) million) for the company and currency forwards with a value of £nil (2016: £0.5 million) for the group and £nil (2016: £0.1 million) for the company;

- Derivatives are used within both the UUPS and ESPS 'other' portfolios to manage liability risks, and comprises £(227.8) million (2016: £(9.0) million) for the group and £(39.2) million (2016: £(1.6) million) for the company in the UUPS and £37.7 million (2016: £49.6 million) for the group and £31.7 million (2016: 41.7 million) for the company in the ESPS. These are further broken down as follows:

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

- The UUPS has a liability hedging strategy in place, which uses a wide range of derivatives to target a high level of interest rate and inflation hedging. The net value of £(227.8) million (2016: £(9.0) million) for the group and £(39.2) million (2016: £(1.6) million) for the company comprise asset swaps with a value of £(132.9) million (2016: £(250.7) million) for the group and £(22.9) million (2016: £(43.1) million) for the company, interest rate swaps with a value of £522.0 million (2016: £631.7 million) for the group and £89.8 million (2016: 108.6 million) for the company, gilt repurchase agreements with a value of £(655.8) million (2016: £(377.6) million) for the group and £(112.8) million (2016: £(64.9) million) for the company and RPI inflation swaps with a value of £38.9 million (2016: £(12.4) million) for the group and £6.7 million (2016: £(2.2) million) for the company; and

- The ESPS has a liability hedging strategy in place, implemented using pooled funds which make use of derivatives. The value of £37.7 million (2016: £49.6 million) for the group and £31.7 million (2016: £41.7 million) for the company represent the total value of these pooled funds, i.e. underlying assets plus the value of the derivatives within these funds.

The derivatives shown in the tables only cover those expressly held for the purpose of reducing certain undesirable asset and liability risks. The schemes also invest in a number of other pooled funds that make use of derivatives. No allowance is made in the figures above for any derivatives held within these, as these are not held expressly for the purpose of managing risk. The total fair value of pooled funds held within the schemes' assets was £1,179.5 million (2016: £1,521.8 million) for the group and £487.7 million (2016: £535.2 million) for the company.

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

		Group		**Company**
	2017 £m	2016 £m	2017 £m	2016 £m
At the start of the year	3,245.6	3,133.7	835.0	816.4
Interest income on schemes' assets	109.4	96.3	28.1	25.2
The return on plan assets, excluding amounts included in interest	555.5	56.0	138.6	7.7
Member contributions	5.2	5.8	0.3	0.3
Benefits paid	(114.3)	(102.4)	(26.6)	(24.4)
Administrative expenses	(2.7)	(2.7)	(0.9)	(1.0)
Company contributions	64.3	58.9	11.8	10.8
At the end of the year	3,863.0	3,245.6	986.3	835.0

The actual return on the schemes' assets was a gain of £664.9 million (2016: £152.3 million) for the group and a gain of £166.7 million (2016: £32.9 million) for the company, principally due to gains on derivatives hedging the schemes' liabilities.

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

Movements in the present value of the defined benefit obligations are as follows:

	Group		Company	
	2017	2016	2017	2016
	£m	£m	£m	£m
At the start of the year	(2,970.4)	(3,054.5)	(786.7)	(812.0)
Interest cost on schemes' obligations	(99.2)	(93.2)	(26.3)	(24.8)
Actuarial (losses)/gains arising from changes in financial assumptions	(721.4)	98.1	(182.9)	26.7
Actuarial gains/(losses) arising from changes in demographic assumptions	52.7	(46.6)	14.8	(11.8)
Actuarial gains arising from experience	36.5	52.6	23.2	12.9
Curtailments/settlements	(3.1)	(1.1)	(0.3)	(0.2)
Member contributions	(5.2)	(5.8)	(0.3)	(0.3)
Benefits paid	114.3	102.4	26.6	24.4
Current service cost	(19.7)	(22.3)	(1.4)	(1.6)
At the end of the year	(3,615.5)	(2,970.4)	(933.3)	(786.7)

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP), which is expected to have a widespread impact for defined benefit schemes operating in the UK. 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 has further developed its proposals, it is not possible to quantify the impact of this change.

Notes to the financial statements – appendices

A6. Related party transactions

Group

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

The related party transactions with the group's joint ventures during the period and amounts outstanding at the period end date were as follows:

	2017	2016
	£m	£m
Sales of services	404.3	1.2
Purchase of goods and services	0.7	0.7
Costs recharged at nil margin under transitional service agreements	18.5	-
Interest income and fees recognised on loans to joint ventures	2.6	-
Amounts owed by related parties	163.5	2.9
Amounts owed to related parties	12.1	-

Sales of services to joint ventures during the year mainly represent non-household wholesale charges and were on the group's normal trading terms.

At 31 March 2017, amounts owed by joint ventures, as recorded within trade and other receivables in the statement of financial position, were £163.5 million (2016: £2.9 million), comprising £41.5 million of trade balances, which are unsecured and will be settled in accordance with normal credit terms, and £122.0 million relating to loans. Included within these loans receivable were the following amounts owed by Water Plus:

- £100.0 million outstanding on a £100.0 million revolving credit facility provided by United Utilities Water Limited, which is guaranteed by United Utilities PLC, with a maturity date of 30 September 2019, bearing a floating interest rate of LIBOR plus a credit margin;

- £9.0 million receivable being the fair value of amounts owed in relation to a £12.5 million unsecured loan note held by United Utilities PLC, with a maturity date of 28 March 2027. This is an interest-free shareholder loan with a total amount outstanding at 31 March 2017 of £12.5 million, comprising the £9.0 million receivable held at fair value, and £3.5 million recorded as an equity contribution to Water Plus recognised within interests in joint ventures; and

- £9.7 million outstanding on a £19.6 million unsecured amortising loan note held by United Utilities PLC, with a final maturity date of 30 November 2017, bearing a floating interest rate of LIBOR plus a credit margin. Repayments received on this loan note represent part of the proceeds received on disposal of the group's non-household retail business (see note 8).

A further £3.3 million of non-current receivables was owed by other joint ventures at 31 March 2017 (2016: £2.5 million).

No expense or allowance has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (2016: £nil).

During the year, United Utilities PLC provided guarantees in support of Water Plus in respect of certain amounts owed to wholesalers. The aggregate limit of these guarantees was £42.5 million, of which £24.0 million related to guarantees to United Utilities Water Limited.

Notes to the financial statements – appendices

A6. Related party transactions (continued)

At 31 March 2017, amounts owed to joint ventures were £12.1 million (2016: £nil). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms.

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

	Interest receivable	
	2017	2016
	£m	£m
Ultimate parent undertaking	27.8	27.9

	Amounts owed by related parties		Amounts owed to related parties	
	2017	2016	2017	2016
	£m	£m	£m	£m
Ultimate parent undertaking	1,674.1	1,646.4	63.5	56.9

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

Company

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

Total dividend income received during the year from subsidiary undertakings amounted to £324.8 million (2016: £264.3 million), including dividends totalling £248.1 million received from United Utilities North West that included an £18.4 million dividend receipt arising on the transfer of the group's non-household retail business by that company, a dividend of £71.4 million paid by United Utilities BV prior to the company's disposal of that subsidiary (see note 12), and a dividend of £5.3 million received from United Utilities (Tallinn) BV.

Total interest receivable during the year from subsidiary undertakings was £29.1 million (2016: £25.5 million), and total fair value gains during the year relating to balances with subsidiary undertakings were £26.8 million (2016: £5.0 million). In addition, total net interest receivable during the year from the ultimate parent company was £27.8 million (2016: £27.9 million). Amounts outstanding at 31 March 2017 between the parent company, subsidiary undertakings and ultimate parent undertaking are provided in notes 14, 20 and A3.

An allowance for doubtful receivables of £89.4 million (2016: £89.7 million) has been made for amounts owed by subsidiary undertakings (see note 14). In the year ended 31 March 2017, a charge of £1.1 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2016: £2.0 million credit).

As at 31 March 2017, total guarantees given by the company to its related parties were £2,018.6 million (2016: £2,033.6 million). Included within these guarantees were the following amounts:

- £1,718.6 million (2016: £1,849.0 million) relating to United Utilities Water Limited's loans from the European Investment Bank;
- £96.5 million (2016: £96.5 million) relating to intra-group loans made between United Utilities Utility Solutions Holdings Limited and United Utilities Water Operations Holdings Limited;
- £100.0 million (2016: £nil) relating to Water Plus's revolving credit facility from United Utilities Water Limited;
- Guarantees with an aggregate limit of £42.5 million (2016: £nil) relating to Water Plus in respect of certain amounts owed to wholesalers, of which £24.0 million related to guarantees to United Utilities Water Limited; and
- Performance guarantees with an aggregate limit of £61.0 million (2016: £88.1 million) given to subsidiaries.

Notes to the financial statements – appendices

A7. Accounting policies

Of the accounting policies outlined below, those deemed to be the most significant for the group are those that align with the critical accounting judgements and key sources of estimation uncertainty set out on pages 38 to 41.

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. In the parent company accounts, investments in joint ventures are held at cost less provision for impairment.

On losing control of a subsidiary disposed of to a joint venture, the group recognises the gain or loss attributable to measuring the investment retained in the former subsidiary at its fair value at the date when control is lost.

Revenue recognition

Revenue represents the fair value of the 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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

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

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

Borrowings designated within a fair value hedge relationship

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

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

Borrowings designated at fair value through profit or loss

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

Derivative financial instruments

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

Derivatives and borrowings – valuation

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

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. For properties held for resale, cost includes the cost of acquiring and developing the sites, including borrowing costs where applicable.

Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Employee benefits

Retirement benefit obligations

The group operates two defined benefit pension schemes, which are independent of the group's finances, for its employees. Actuarial valuations to determine the funding of the schemes, along with future contribution rates, are carried out by the pension scheme actuary as directed by the trustees at intervals of not more than three years. In any intervening years, the trustees review the continuing appropriateness of the funding and contribution rates.

From a financial reporting perspective and in accordance with IAS 19, defined benefit assets are measured at fair value while liabilities are measured at present value, using the projected unit credit method. The difference between the two amounts is recognised as a surplus or obligation in the statement of financial position. Where this difference results in a defined benefit surplus this is recognised in accordance with IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction' on the basis that the group has an unconditional right to a refund of any surplus that may exist following the full settlement of plan liabilities in a single event.

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within employee benefits expense, while the interest on the schemes' assets and liabilities is included within investment income and finance expense respectively. Remeasurement gains/losses on scheme assets and liabilities are presented in other comprehensive income.

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

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.

Notes to the financial statements – appendices

A7. Accounting policies (continued)

Foreign currency translation

Transactions and balances

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period.

Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity. In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note 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 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 Solutions (Industrial) Limited	Ordinary	100.0	Holding company
United Utilities Utility Solutions 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
UU (ESPS) Pensions Trustee Limited	Ordinary	100.0	Corporate trustee
UU Group Limited	Ordinary	100.0	Dormant
UU Secretariat Limited	Ordinary	100.0	Dormant
YCL Transport Limited	Ordinary	100.0	Non-trading
United Utilities Bioresources Limited	Ordinary	100.0	Wastewater services
The Netherlands			
United Utilities (Tallinn) BV	Ordinary	100.0	Holding company
Thailand			
Manta Management Services Limited(1)*	Ordinary	49.0	Management company
Water Resources Limited(1)*	Ordinary	100.0	Non-trading

Notes to the financial statements – appendices

A8. Subsidiaries and other group undertakings (continued)

	Class of share capital held	Proportion of share capital owned/voting rights %	Nature of business
Joint ventures			
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
Water Plus Group Limited(2)	Ordinary	50.0	Holding company
Estonia			
AS Tallinna Vesi(3)*	Ordinary	35.3	Water and wastewater services
Associated undertakings			
Bahrain			
Muharraq STP Company BSC(c)(4)*	Ordinary	20.0	Project company
Muharraq Wastewater Services Company WLL(4)*	Ordinary	35.0	Operations and maintenance company
Jebel Ali Free Zone, Dubai, UAE			
Muharraq Holding Company 1 Limited(5)*	Ordinary	20.0	Holding company

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

Notes:

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

(2) Registered address: Two Smithfield, Leonard Coates Way, Stoke-on-Trent, United Kingdom, ST1 4FD.

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

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

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