Registered No: 2366616

United Utilities PLC

Annual Report and Financial Statements

31 March 2018

Contents

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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 purpose and strategy

Our purpose is to provide great service to our customers and communities in the North West, creating long-term value for all of our stakeholders.

Our vision

Our vision is to be the best UK water and wastewater company.

Our strategy

We will realise our vision by delivering:

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

We use these three strategic themes as a framework to measure each aspect of our performance with each of our operational key performance indicators and risks closely linked to one of them or, often, to more than one, such is the interconnectivity of our business.

Our core values

Our core values provide the cultural framework within which we are working towards achieving our vision, and we encourage our employees to live these values in everything they do in their daily work:

Customer focus

Everything we do is about our customers, not us. We put customers at the heart of everything we do so that we can give them our best service.

This means not only supplying the seven million people and 200,000 businesses in our region with clean water and treating their wastewater every day, but also improving our customer contacts, keeping bills down, and giving extra help to those vulnerable customers who need it most.

Customer focus means putting customers first now, and also building a resilient and sustainable network to prepare for future generations.

Innovation

The world doesn’t stand still and neither do we. We will continue to innovate to make our services better, safer, faster and cheaper. We’re always searching for new and better ways of working, adapting our service to suit the needs of our region’s diverse population.

Only by making the best use of new processes and technologies can we ensure we are prepared for a growing population and extreme weather, to ensure we continue to deliver the lowest sustainable cost in an ever changing world.

One example of innovation that spans our entire business is our Systems Thinking operational approach.

Integrity

We make promises knowingly and keep them.

We behave responsibly towards all of our stakeholders, including our customers; the communities we operate in; our employees; our suppliers; and the environment.

Strategic report

Our competitive advantage

How we offer value

The following are key features that we believe offer value to our stakeholders, alongside the specific differentiating factors described below:

- Clarity on allowed returns through to 2020, with a track record of regulatory outperformance;
- Wholesale revenue and asset base linked to RPI inflation to at least 2020;
- Planning for the long term, protecting and delivering essential services;
- Significant improvements in customer service and operational performance, with more to come;
- Sustainable dividend policy, targeting a growth rate of at least RPI inflation per annum to at least 2020;
- Robust capital structure with a stable A3 credit rating;
- Customer and environmental benefits delivered through substantial capital investment, driving long-term RCV growth; and
- Deeply integrates with the environment, with external recognition for our responsible business approach.

For more information in relation to our values, please see pages 12 to 13 of the 2018 UUG annual report and financial statements.

Our business model

Key resources

Natural Resources

How our natural resources help us to create value

We hold abstraction licences that permit us to utilise the natural environment in the North West to create value for our business. Raw water is collected from our catchment land and stored in our reservoirs, or is taken directly from rivers and boreholes. This key resource is essential in order for us to continue providing water to our customers' taps once we have treated it.

We own over 56,000 hectares of land, much of which is catchment land around our reservoirs. As well as providing a source for raw water collection, the way we manage this land helps to protect and improve the natural environment in the North West, enhancing recreational value for the community and providing economic benefits such as underpinning the region's tourist industry.

Another value-generator can be found in the waste that we collect. Bioresources from wastewater can be processed to generate renewable energy. Our advanced digestion facility at our Davyhulme wastewater treatment works is one of the largest of its type, and we inject biogas from Davyhulme's wastewater treatment into the national gas network. We recycle waste by supplying treated biosolids to agriculture, providing a valuable resource for farmers as high quality fertiliser.

We have a responsibility to return water to the environment safely after extensive cleaning processes. Spills from our network can lead to pollution which, depending on the severity, can damage the natural environment and potentially lead to loss of reputation and/or financial penalties.

Strategic report

The best service to customers

Providing the best service to customers goes beyond the provision of water and wastewater services and looks at ways we can add further value. We help customers to save money on their bills through our water-saving initiatives, efforts to reduce leakage, and ‘what not to flush’ campaigns to prevent blockages.

At the lowest sustainable cost

The generation of renewable energy from bioresources helps to save power costs, and we seek to use the lowest cost sources where practicable and innovate to find the most cost-effective methods to treat water and wastewater.

Preparing our network to cope with the extreme weather and potential effects of a changing climate we are both experiencing and predicting for the future can save repair and recovery costs as well as ensuring a more resilient service for our customers.

In a responsible manner

We continue to invest in the protection and, where appropriate, enhancement of the natural environment of the North West.

Much of our catchment land is open to the public for use and enjoyment by our communities and the tourists that visit our region.

We consider the natural environment in the management, operation and maintenance of our sites, helping to support rare species and habitats. Wildlife is not only protected, but frequently improved, as a result of our interventions.

Our Sustainable Catchment Management Programme (SCaMP) has shown that we can manage our catchment land to protect and enhance water quality and to provide other benefits for the North West, such as an improving biodiversity.

Our approach to integrated catchments looks at working with others to improve the lakes, rivers and coastal waters where we return treated wastewater in the North West.

Rainfall in our region is greater than in other parts of the country, and therefore short, medium and long-term water supply is not as constrained. Nonetheless, it is in everyone’s interest to make the most of this precious resource. Reducing demand for water is important, and our efforts to encourage and support water efficiency are increasing. We encourage customers to save water, and are working with external partners to integrate our messaging further afield, as well as working to reduce leakage.

The use of bioresources provides an ongoing opportunity to reduce carbon emissions, helping in the global fight against climate change as well as saving money that can be used to add further value by investing in improving the resilience of our assets and/or by reducing bills for customers.

We can make an important contribution to protecting and enhancing the natural environment by using fewer natural resources and reducing our greenhouse gas emissions.

While providing water and wastewater services to the North West, we produce waste materials such as sludges, excavated materials and general office waste, which we are committed to managing in a sustainable way, with less than five per cent of our waste going to landfill.

We are looking at ways to lessen our use of raw materials to reduce our impact on the environment and make us more efficient, and we use recycled products where practicable.

We are working on plans to substantially increase our renewable energy production across this 2015–20 regulatory period, with the main contributor being solar opportunities. This will provide environmental benefits as well as adding value through energy cost savings.

Strategic report

How we manage our natural resources

Our ISO accredited environment management system covers the whole business and our environmental policy is available on our website at: *unitedutilities.com/corporate/responsibility/environment.*

This policy details our commitments to:

- Manage water resources sustainably and promote water efficiency;
- Improve the North West's bathing waters through our work and that of others;
- Act to prevent pollution from our operations and inform our customers on the responsible disposal of waste to our sewers;
- Protect and enhance the natural environment and the services it provides;
- Manage our use of natural resources, reduce waste and put it to valuable uses;
- Consider the impacts of climate change on the services we deliver and adapt our business accordingly;
- Reduce our greenhouse gas emissions and generate more renewable energy;
- Aim to observe legal and regulatory requirements and appropriate industry codes of practice; and
- Integrate environmentally responsible behaviour into our operations.

Our regulatory framework shapes the way that we manage natural resources as we are governed by environmental regulators.

Protecting and enhancing the environment is one of the promises and key outcomes that we committed to deliver as part of our business plan for the current regulatory period, and features as one of our Business Principles, which can be accessed online at: *unitedutilities.com/corporate/about-us/governance/business-principle.*

We continuously encourage our customers to use water more efficiently and have increased the number of households fitted with meters.

In terms of managing water supply and demand, we already have an integrated supply zone covering the majority of the North West. Generally, this system is proficient in managing demand, but there are extremities that require further improvements to deal with future challenges. Where there is any potential shortfall, we bring more supplies online to meet demand.

We have a regulatory annual leakage target, based on the sustainable economic level of leakage, which is one of our operational KPIs, and we have consistently met or outperformed this target.

As a major owner of woodland we manage our trees in a sustainable way to protect water quality, conservation, access, recreation and timber, and we have been Forest Stewardship Council® (FSC®) certified since 2003.

The sustainable management of surface water is vital in adapting to the predicted increase in more intense rainfall across the region, which is the key risk to our wastewater service.

We are one of many organisations with a role to play in boosting the quality of bathing water on the North West coast. With strict bathing water standards, we continue to work with partners to improve the quality of rivers and coastal waters, and we give the public real-time information on bathing water quality.

The Environment Agency assesses water companies' performance across a basket of measures, such as regulatory compliance, pollution incidents and improvement plans, and its overall assessment is included as one of our operational KPIs.

Strategic report

Impact of the external environment

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.

Climate change is the long-term change in average weather conditions, including temperature, rainfall and wind. It is predicted that our climate will change dramatically and for the North West, this will result in higher daily temperatures in both winter and summer, and a shift in our rainfall from summer to winter.

This will mean there is likely to be:

- More frequent and/or higher magnitude drought events in summer;
- More rainfall in the winter; and
- More occurrences of heavy rainfall.

Climate change has been the subject of strategic concern to us for over two decades. As a water and wastewater utility provider, we have first-hand experience of the impacts of extreme weather events on our operations and our customers, and we recognise our part to play in mitigating 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.

Our response to climate change can be split into two areas:

- Adaptation – making sure our services are resilient to a changing climate.

The potential effect of climate change on our future water resources is included in our 25-year Water Resources Management Plan, and we have published two adaptation reports, in 2011 and 2015, outlining our holistic, integrated and partnership approach to a range of short, medium and long-term challenges including climate change.

- Mitigation – reducing the carbon emissions associated with our services, especially through our energy strategy.

The key factor in climate change is an increase in greenhouse gases. There is global scientific agreement that as a result of human activity the amount of greenhouse gases in the atmosphere is increasing and affecting the global climate. Therefore minimising the greenhouse gases emitted as a result of our operations will mitigate climate change.

We have been driving down our carbon footprint over the last decade (a reduction of one-third since 2005/06) and have plans to reduce it further.

More information on our approach to all of these impacts and our environmental performance can be found on our website at: *unitedutilities.com/corporate/responsibility/environment/environment-performance.*

People

How our people help us to create value

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.

Our suppliers and contractors provide us with essential services that we rely on to deliver our strategy. Our suppliers are contributing significantly towards the around £9 billion forecast contribution we are making to the regional economy over the 2015–20 period.

Strategic report

The best service to customers

Our people, both our employees and our supply chain, act as the face of our business for our customers, and therefore are a crucial part of delivering the best service to customers across our entire business.

At the lowest sustainable cost

Independent studies have shown that competitive wages, benefits and long-term incentives enhance the quality of work, increase employee retention and reduce absenteeism, as well as providing societal benefits, which helps to ensure efficient costs in relation to salaries and training. Comprehensive training and development opportunities for our employees help to improve our internal skills-base and therefore quality of work at an efficient cost, as well as creating a more engaged workforce.

In a responsible manner

We are supporting thousands of jobs in the North West, we have been named as one of the top 100 apprenticeship employers and have a growing graduate programme, helping to secure a legacy for the future in our region.

We work with our supply chain partners to give young people not in education, employment or training (NEETs) the chance to gain hands on experience and basic skills training in a real workplace environment, bringing social economic benefit to the region.

We are committed to promoting a safe, happy and diverse workforce and we maintain a comprehensive suite of policies, from ‘Agency worker’ to ‘Working time’ which are available to all employees on our intranet.

How we manage our people

Our employees are paid a competitive base salary along with a benefits offering and the opportunity to join both the employee healthcare scheme and our share incentive plan. We measure employee engagement each year through our Employee Voice survey and achieved 79 per cent in the latest survey, which is higher than the UK norm. 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.

We place a strong emphasis on providing comprehensive training and development opportunities for our employees. 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.

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.

We value diversity, providing equal opportunity and recruiting and promoting employees on the basis of merit, which we believe drives a more comprehensive and balanced skills-set. Despite being a highly engineering-based organisation, women are represented at all levels of our company. Over a third of our combined board and executive team is female.

Over the last few years, we have been striving to improve diversity at all levels and across all types of roles within our business, including establishing our Gender Equality Network in 2015 to provide role models, mentoring and opportunities, and targeting diverse shortlists and attraction campaigns for our apprentice and graduate schemes.

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, where it is safe and practical to do so.

Strategic report

Our Human Rights policy demonstrates our commitment to protecting the human rights of our employees and supply chain. We convened a cross-company working group to draft the policy statement, and identify and assess human rights risks and potential impacts on our employees, customers, suppliers and communities. This group identified our salient human rights issues as access to clean water, data protection and privacy, health and safety, and modern slavery.

We work with suppliers and contractors whose business principles, conduct and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter. We support the appointment of a small business commissioner to investigate companies who do not treat suppliers fairly, are a signatory to the Prompt Payment Code, and will fully comply with rules on reporting payments to suppliers.

Impact of the external environment

The availability of skilled engineers is dependent on economic and social conditions and preferences. 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.

To date, we have not identified any human rights abuses within our own operations nor our supply chain and so no remediation actions have been required. We have mapped our human rights risks against our corporate risk register and manage them within this framework. Our supply chain modern slavery risk management plan is detailed in our Slavery and Human Trafficking Statement.

Assets

How our assets help us to create value

Many of our assets are long-term in nature, for example our impounding reservoirs have a useful economic life of around 200 years. We earn a return, received through revenues, based on a regulatory measure of the value of our capital asset base, Regulatory Capital Value (RCV). This mechanism allows us to share the cost of building these long-term assets between the generations that will benefit from the use of those assets.

Our RCV is currently just over £11 billion, however the gross replacement cost of our fixed assets (including all our reservoirs, treatment works and pipes), i.e. the estimated amount it would cost for another company to build similar assets and networks, is around £90 billion. We expect to invest around £3.8 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.

We manage our assets in a holistic way that seeks to minimise whole life costs, which helps us to deliver efficient totex against our regulatory allowance.

The best service to customers

Since privatisation in 1989, total capital investment of over £15 billion has provided substantial benefits to our customers, including reduced supply interruptions and improved water quality.

At the lowest sustainable cost

By carefully reviewing our potential capital projects, and considering the most efficient long-term solutions in terms of the lowest whole-life cost, we can save future operating costs, help to reduce future customer bills, and work towards being able to operate in a more sustainable manner. Disciplined investment, along with RPI inflation, also grows our RCV, increasing future revenues.

In a responsible manner

Effective capital investment helps us to meet increasingly stringent environmental standards, which helps to improve the region’s environment and protect indigenous wildlife, as well as contributing to the North West’s economy through job creation, both within our company and through our supply chain.

Strategic report

How we manage our assets

When deciding on our investment strategy we need 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.

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.

We are committed to managing and operating our water, wastewater and energy assets to ensure we continue to provide a water and wastewater service that helps life flow smoothly for our customers, regulators and other stakeholders.

We have an asset management policy that is available to all employees on our intranet that details how we will operate, maintain and invest in our assets with the aim of delivering our customer promises and their associated outcomes, as agreed at the price review for the current regulatory period.

Impact of the external environment

We anticipate an increase in the North West's population of around 900,000 by 2045 (more than the population of a large city such as Liverpool).

We are planning to ensure that our services and supporting infrastructure are able to meet the needs of this growing population, which is also expected to include a higher proportion of older people. We must ensure we are able to meet increased demand on both our water and wastewater networks as the regional population is expected to increase.

We must build increased resilience into all of our assets in order to cope with the anticipated impacts of a changing climate. Our assets must be prepared to meet the changing and increasingly challenging environmental constraints that we have to comply with in regard to areas such as water abstraction, increasingly stringent wastewater treatment levels, and improvements to flood defences as a result of increasing extreme weather conditions.

There is need for a careful balance between preparing for future challenges and maintaining affordable bills by phasing the work and cost. We must strike a balance between the various interests of customers and our many regulators, as well as political and societal interest.

A phased, long-term approach to address all of these concerns ensures that the necessary work can be delivered without placing too much pressure on customer bills.

Technology and innovation presents an opportunity, for example the new wastewater treatment process, Nereda, has transformed this area, our use of robots in managing the water network has driven greater efficiency and improved customer service, and we are using drones to inspect assets with restricted access to improve health and safety as well as reduce time and costs.

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 we built Europe's largest floating solar array system on our reservoir in Godley, Greater Manchester.

Advances in technology can be used to help deliver improvements in the quality and/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 to operating our network is a key example of this.

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

Strategic report

For information on principal risks and uncertainties in this area, see pages 23 to 29 'Security risk', 'Water service risk', 'Wastewater service risk', 'Compliance risk', and 'Supply chain and programme delivery'.

Financing

How our financing helps us to create value

We aim to maintain a robust and sustainable capital structure, balancing both equity and debt, to achieve a strong investment grade credit rating, thus enabling efficient access to the debt capital markets across the economic cycle.

We adopt a prudent approach to managing financial risks, which helps to ensure financial resilience in the long term. We have a long track record of aligning our financial risk management with the regulatory model through inflation and interest rate management policies, which helps us manage uncertainty in volatile market conditions and when faced with changes in Ofwat's approach to setting the cost of debt at each price review.

The best service to customers

Customers benefit from reductions to bills and lower finance costs contribute to our ability to deliver this.

Customers also appreciate receiving the benefit of service improvements earlier rather than later, and the ability to efficiently finance our business helps enable us to deliver this.

At the lowest sustainable cost

Locking in long-term debt and swaps at good relative value can help keep our finance costs low and provides the potential to outperform the industry-allowed cost of debt.

The long-term average life of our debt portfolio, our strong and stable investment grade credit rating, robust hedging policies, and maintaining access to a broad range of sources of finance, all help to ensure that our ability to efficiently finance our business is sustainable, and to reduce our exposure to the risk of fluctuating market conditions and changes in the regulatory environment.

In a responsible manner

We have open and transparent reporting around all of our equity and debt financing arrangements.

We do not utilise offshore financing vehicles, and we maintain an appropriate level of gearing, measured as net debt to regulatory capital value (RCV), broadly in line with regulatory assumptions, which supports a robust and sustainable capital structure.

How we manage our financing

We have proactive programmes of engagement with equity and credit investors, which allows us to hear their views, which we then consider in our strategic planning, and also to update them on developments in our business.

As part of our planning process, we review key credit ratios to ensure these meet required thresholds in order to satisfy the board's ratings targets. Performance against business plan credit ratios is regularly monitored, and we maintain close contact with the credit rating agencies to understand the methodology and any changes. Gearing is maintained within our target range of 55 per cent to 65 per cent, which broadly mirrors regulatory assumptions.

Issuing new debt is 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 and diverse range of sources of finance, in a number of markets, across which we seek best relative value when issuing new debt. We manage relationships with a diverse range of banks, and we refresh our European Medium Term Note (EMTN) Programme annually to allow for efficient issuing of debt under pre-agreed contractual terms.

Strategic report

We aim to avoid a concentration of refinancing in any one year, and tend to fund long-term where possible, with the average life of our term debt being just under 20 years. We regularly review liquidity forecasts against our policy of having available resources to cover the next 15–24 months of projected cash flows. This helps ensure forward funding requirements are met.

We have clearly articulated financial risk management policies, covering credit, liquidity, interest rate, and currency risk, and we responded proactively to Ofwat's intention to transition from RPI to CPIH inflation and to index the portion of new debt in calculating the cost of debt in the next regulatory period.

We have conducted an extensive review of our inflation and interest rate hedging policies and amended these to align with the new regulatory model and continue to maintain the most appropriate financial risk management. We will no longer substantively fix all of our nominal debt at the start of each regulatory period, but maintain a rolling ten-year fixing profile on nominal debt to mirror Ofwat's assumed 70 per cent embedded and 30 per cent new debt split (with debt indexation on the new debt portion). We aim to retain around half of our net debt in index-linked form (where it is economic to do so), by issuing index-linked debt and/or swapping a portion of nominal debt. This is expected to remain mostly in RPI-linked form until CPI/CPIH debt and swaps become available in sufficient size at an economic cost.

We are the sector leader in CPI inflation linked financing, having issued the first ever CPI-linked notes by a UK utility and have continued to build the CPI-linkage in our debt portfolio where good relative value opportunities can be found.

Impact of the external environment

Changes in economic conditions and financial markets, such as inflation and interest rates, can influence our ability to create value through financing. While these 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 financial hedging strategies. In this way we can create value by reducing the risks to which we are exposed.

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 2017/18. Comparatively low interest rates have been beneficial to our future cost of debt as we continue with our nominal interest rate hedging strategy.

RPI inflation has continued to rise during 2017/18, briefly reaching levels as high as 4.1 per cent, but returning to 3.3 per cent at March 2018, compared with 3.1 per cent at March 2017. However, it has been lower over recent years than levels it has reached in the last 10 years. The prices we charge our customers (which drive our revenue) and our regulatory capital value (RCV) are linked to RPI inflation for the current regulatory period, therefore lower RPI over recent years has meant slightly lower growth on these measures. However, as a result of our large quantity of index-linked debt, our finance costs decrease as inflation falls, providing a partial economic offset to revenue.

Our pension liabilities are linked to RPI inflation, and have been hedged by a combination of a market hedge and the inflation funding mechanism (IFM), whereby company contributions are flexed for movements in RPI. We expect the schemes to increase the market hedge for inflation in line with a progressive de-risking strategy, with a corresponding reduction in the IFM.

Market sentiment can also have an impact on our financing. While much of this can be outside of our direct control, there are ways in which we are able to help inform and influence public opinion.

Internal environment

Governance

Good governance lies at the heart of all successful organisations. We firmly believe that it leads to better management decisions as well as helping to avoid exposure to potential risks and improving corporate resilience.

Strategic report

We strive to operate in a manner that reflects the highest standards of corporate governance, accountability and transparency. 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.

We have an anti-bribery policy that all our employees must follow, and processes in place to monitor compliance with the policy. This policy is available to view online at *unitedutilities.com/corporate/about-us/governance*.

We also operate an independently provided, confidential reporting telephone helpline and web portal for employees to raise matters of concern in relation to fraud, dishonesty, corruption, theft, security and bribery, and all claims are fully investigated.

Our employees and representatives of our suppliers must also comply with our sustainable supply chain charter, which explains that we will not tolerate corruption, bribery and anti-competitive actions and we expect our suppliers to comply with applicable laws and regulations and in particular never to offer or accept any undue payment or other consideration, directly or indirectly, for the purposes of inducing any person or entity to act contrary to their prescribed duties.

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 being run in a cost-effective way.

Given the complex legal and regulatory environment within which we operate, we are exposed to a range of risks.

An important risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our financeability, as well as the outcomes we will deliver for customers, and that we provide sufficient information to Ofwat to ensure we receive a final determination that covers these, as we are bound by these plans for the following five-year period with limited opportunity to change them. Failure to meet the terms of our current 2015–20 regulatory contract is a risk.

We face risks in relation to potential future changes in legislation or regulation. This includes the anticipated changes for the 2020–25 regulatory period and increased political scrutiny with discussion of the potential Renationalisation of the water industry, as well as potential changes further into the future.

We also face risks such as possible non-compliance with existing laws or regulations, and from environmental impacts such as climate change.

See pages 23 to 29 for more details on what we consider to be our principal risks and uncertainties.

Values and culture

We are committed to delivering our services in a responsible way and our approach to responsible business practice is outlined in our Business Principles document, which is available on our website at: *unitedutilities.com/corporate/about-us/governance/business-principles*.

Our culture is embodied in our three core values of customer focus, integrity and innovation, and we operate with these at all levels of our business. These core values are interrelated – innovating to improve our services and acting with integrity in the way we conduct our activities helps us to continually improve customer service.

Customer focus

We have instilled a customer-centric approach right across our organisation, and this evolving culture has been a key driver of the major improvements in customer service we have been able to deliver.

Putting customers at the heart of what we do has also helped deliver benefits for shareholders and wider stakeholders.

Strategic report

Integrity

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 engagement and social channels, such as our annual 'Employee Voice' survey, through news articles on our intranet, and on our social media collaboration tool 'Yammer'.

Innovation

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 and from wider industries across the world.

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 planning cycles

Our approach to planning

The three business areas within our business model – wholesale water, wholesale wastewater, and household retail – are structured in line with Ofwat's distinct price controls for the current regulatory period.

The fourth price control, non-household retail, is regulated within our 50:50 joint venture with Severn Trent, Water Plus. While we can influence it, we cannot control this joint venture and it is not part of our consolidated group, therefore it does not form part of our group's business model.

Each business area undertakes both long, medium and short-term planning to identify how they can best deliver their outcomes now and in the future.

We have planning cycles that cover:

- 25+ years – reflecting the long-term nature of our business, which provides an essential service to customers, and helping us to define what we need to deliver in each five-year regulatory period to ensure long-term resilience;
- 5 years – reflecting the regulatory review periods within which our revenue allowances are set, and helping us move towards achievement of our long-term goals; and
- 1 year – reflecting the annual targets we set to help move us towards achievement of our five-year goals.

Our plans take into account the internal and external drivers and relationships described in our business model, and we adopt an integrated approach that consults with and considers the interests of a whole range of stakeholders.

Underpinning our approach to planning, we continuously assess our performance using key performance indicators (KPIs) and other performance measures, which help us to formulate our future improvement plans for our various stakeholders.

Planning – 25 years+

In order to maintain a reliable, high quality water service for our customers into the future, 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.

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

- Climate change and its implications for water resources and flooding;

Strategic report

- A more open, competitive UK water market;
- More rigorous environmental regulations;
- Population growth;
- Developments in technology;
- The UK's exit from the European Union; and
- Combining affordable bills with a modern, responsive service.

By anticipating and planning ahead for these, we can ensure that we continue to deliver **the best service to customers, at the lowest sustainable cost, in a responsible manner.**

Our strategy for the future is set out on our web pages where we examine the challenges ahead and how we will focus our resources and talents in order to meet them. Our current 25-year Water Resources Management Plan (WRMP) was published in 2015 covering the 2015–40 period.

We have recently finished consulting with customers and stakeholders to ensure their interests are reflected in our new 25-year WRMP, which covers the 2020–45 period and will be submitted to Defra in August 2018.

These long-term plans set 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 are aiming to 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 sustainable whole-life cost modelling;
- Efficiently implementing a robust and appropriate mix of debt and equity financing;
- Embracing innovation and our Systems Thinking approach to make our future services better, faster, safer and cheaper;
- Long-term planning and management of water resources (25-year WRMP);
- Responding to the many challenges and opportunities we face, including climate change and population growth; and
- Sustainable catchment management.

More information can be found at unitedutilities.com/corporate/about-us/our-future-plans/lookingto-the-future.

Planning – 5 years

Each five-year regulatory contract is designed with our strategic themes in mind and aims to help us to work towards our long-term plans and ultimately to achieve our long-term vision. We submit a robust, balanced plan to Ofwat in order to agree a regulatory contract that allows for the best overall outcomes for our customers, shareholders and the environment.

Once each 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 the 2010–15 regulatory period focused on improving customer satisfaction, meeting our statutory obligations, and delivering shareholder value. We delivered on each of these, which provided us with a strong platform to deliver further in the current 2015–20 regulatory period.

Strategic report

Some of the key ways we are aiming to create value over the 2015–20 regulatory period 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 to fix medium term interest rates and power costs*** – helping 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; and
- ***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 for remote monitoring and control of 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 customer contacts 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 continuous improvement in our operational efficiency; and
- Work to link 150,000 customers in West Cumbria to Thirlmere reservoir to ensure a long-term, reliable supply of drinking water and to support the sensitive ecology in that area.

Wholesale wastewater

- Continue to improve the way we operate, making better use of technology, automation and control to drive better customer service at reduced cost, and build on customer satisfaction improvements already delivered;
- Reduce the number of our customers’ properties exposed to sewer flooding, working in partnerships to deliver schemes cost-effectively and promote the use of more sustainable drainage systems;
- Improve bathing waters to meet tougher regulatory standards, and work with other organisations to support them in delivering improvements to our region’s beaches;

Strategic report

- Improve water quality in the North West's rivers and lakes through investment in our treatment works and at overflows, and engage with others to explore innovative catchment management techniques to control diffuse pollution in our catchments;

- Increase production of renewable energy from waste to protect customers from rising energy costs and reduce our carbon footprint; and

- Constrain the costs of 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, anticipating problems before they materialise and improving our communication channels;

- Reduce the number of customer complaints further, 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, 'Restart', 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 current price control methodology which uses an industry average retail cost to serve to determine part of customer bills.

Adapting our plans to meet our customers' evolving needs

The North West remains the most socially and economically deprived region in England, which is the principal driver of our higher than average cost to serve for household customers. This is currently recognised by Ofwat through an additional cost allowance for deprivation of £20 million per annum over the 2015–20 regulatory period.

A report from the Department for Communities and Local Government in 2015/16 reaffirmed that the North West has the most deprived regions in England, containing three of the top five local authority districts with the highest proportion of 'highly deprived' neighbourhoods (categorised as the most deprived ten per cent).

Bad debt remains a risk, particularly with the continuing tightening of real disposable incomes and the impact of welfare reforms likely to intensify. Our debt management processes have been externally benchmarked as efficient and effective. We continue to refine and enhance them, whilst also helping customers back into making regular payments through the use of manageable payment plans.

We 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 elderly customers.

We are also adapting to the increasing use of social media and digital technology. We have recognised the increasing power of social media as communication channels for customers in doing business with us, and have invested in a new digital external communications capability and a number of website improvements that were built through consultation with our customers.

Planning – 1 year

Before the start of each financial year, we develop a business plan for that year, which is approved by UUG board.

This sets our annual targets, which are designed to help deliver further improvements in service delivery and efficiency, and to help move us towards achievement of our five-year goals.

Strategic report

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

Our one-year targets help us to measure progress towards our five-year goals, which in turn help us work towards our long-term plans and, ultimately, our vision to be the best UK water and wastewater company.

This top-down approach helps us to ensure the long-term resilience and sustainability of our business through short and medium-term goals that we can monitor and measure our progress against.

Performance monitoring

The executive directors hold quarterly business review meetings with senior managers 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.

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:

- Provide great water
- Dispose of wastewater
- Deliver a service customers can rely on

At the lowest sustainable cost:

- Value for money
- Improved efficiency

In a responsible manner:

- Protect and enhance the environment
- Support local communities
- Support employees in a safe workplace

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.

Strategic report

	Year ended 31 March 2018	Year ended 31 March 2017
Financial KPIs		
Revenue	£1,736m	£1,704m
Underlying operating profit (1)	£645m	£623m
Underlying profit before tax (1)	£396m	£417m
Underlying profit after tax (1)	£326m	£336m
Regulatory capital expenditure (2)	£816m	£804m
Gearing: net debt to regulatory capital value (3)	61%	61%
Performance summary		
Operating profit	£636m	£606m
Profit before tax	£458m	£470m
Profit after tax	£375m	£456m

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 22. Further details of underlying profit measures can be found on pages 52-53 of the UUG 2018 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 shadow RCV (out-turn prices).

Financial performance

Revenue

Revenue was up £32 million, at £1,736 million, reflecting our allowed regulatory revenue changes, partly offset by the impact of our Water Plus JV, which completed on 1 June 2016 and the below regulatory adjustments.

With regard to Ofwat's revenue correction mechanism, relating to the 2014/15 financial year, we have around £9 million to return to customers. As we have previously indicated, we have begun to return this to customers with a revenue reduction of around £3 million in 2017/18, with further revenue reductions proposed of around £3 million in both of 2018/19 and 2019/20. This approach has been adopted to help aid a smoother bill profile.

Separately, consistent with Ofwat's annual wholesale revenue forecasting incentive mechanism (WRFIM), revenue has also been reduced in 2017/18 by £10 million as actual volumes in 2015/16 were higher than our original assumptions. We will further be reducing revenues in 2018/19 by £4 million as actual volumes in 2016/17 were also higher than our original assumptions.

Operating profit

Reported operating profit increased by £30 million, to £636 million, reflecting the increase in underlying operating profit, along with a reduction in adjusted items. Adjusted items for 2017/18 amounted to £9 million, £6 million of which related to restructuring costs. Adjusted items in the prior year amounted to £17 million, £10 million of which related to restructuring costs.

Underlying operating profit at £645 million was £22 million higher than last year. This reflects our allowed regulatory revenue changes, partly offset by an expected increase in depreciation and 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.

Investment income and finance expense

Reported net finance expense of £219 million was higher than the £203 million expense in 2016/17. This £16 million increase principally reflects the increased indexation charge in the year of £57 million which has

Strategic report

been partly offset by an increase in the fair value gains on debt and derivative instruments, from a £24 million gain in 2016/17 to a £47 million gain in 2017/18.

The underlying net finance expense of £252 million was £42 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 £92 million was £17 million lower than last year, due to the lower rates locked in on our interest rate swaps and the re-couponing of a portion of our regulatory swap portfolio. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £138 million, compared with a net charge of £81 million last year. As at 31 March 2018, the group had approximately £3.7 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 4.2 per cent being higher than the rate of 3.8 per cent for the year ended 31 March 2017. The average underlying interest rate represents the underlying net finance expense divided by average debt.

The group has fixed the substantial majority of its non index-linked debt for the 2015–20 regulatory period.

Profit before tax

Reported profit before tax was £458 million, £12 million lower than last year due to the increase in operating profit being more than offset by fair value movements, as outlined in the underlying profit measures table on page 22 and the £22 million profit in 2016/17 on disposal of the non-household business.

Underlying profit before tax was £396 million, £22 million lower than last year, primarily reflecting the £22 million increase in underlying operating profit was more than offset by the £42 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 22.

Tax

In addition to corporation tax, the group pays significant other contributions to the public finances on its own behalf as well as collecting and paying over further amounts for its 5,000 strong workforce. The total payments for 2017/18 were around £242 million and included business rates, employment taxes, environmental taxes and other regulatory service fees such as water abstraction charges as well as corporation tax.

In 2017/18, we paid corporation tax of £36 million, which represents an effective cash tax rate on underlying profits of 10 per cent, which is 9 per cent lower than the headline rate of corporation tax of 19 per cent. 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 12 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 £30 million in 2017/18, compared with £60 million in the previous year; the main differences being timing in nature with a corresponding equal and opposite adjustment to deferred tax. There were current tax credits of £7 million in 2017/18 and £23 million in 2016/17, following agreement of prior years' tax matters; in addition to UK tax, the prior year figure also included the release of a provision in relation to agreed historic overseas tax matters.

For 2017/18, the group recognised a deferred tax charge of £52 million, compared with a charge of £28 million for 2016/17. In addition, the group recognised a deferred tax charge of £7 million in both 2016/17 and 2017/18 relating to prior years' tax matters. 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.

Strategic report

The total tax charge for 2017/18 was £82 million as compared to a total tax charge of £14 million for 2016/17, the main differences being the £58 million deferred tax credit relating to changes in tax rates in 2016/17 together with the higher current tax credit in 2016/17 in respect of prior years. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 19 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium term.

Profit after tax

Reported profit after tax was £375 million, compared with £456 million in the previous year, due to the £13 million reduction in reported profit before tax and the £68 million higher tax charge as 2016/17 included a deferred tax credit of £58 million relating to changes in the Government's future planned tax rate and a further tax credit of £16 million relating to prior years' tax matters.

Underlying profit after tax of £326 million was £10 million lower than last year, principally reflecting the £22 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits and the reduction in the headline rate of corporation tax.

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 52 to 53 of the UUG 2018 Annual Report.

	Year ended 31 March 2018	Year ended 31 March 2017
Operating profit	£m	£m
Operating profit per published results	636.4	605.5
Flooding incidents (net of insurance proceeds recognised)	1.7	1.5
Non-household retail market reform	1.0	5.8
Restructuring costs	6.0	10.1
Underlying operating profit	645.1	622.9
Net finance expense		
Finance expense	(218.6)	(202.7)
Investment income	37.4	41.5
Net finance expense per published results	(181.2)	(161.2)
Adjustments:		
Net fair value gains on debt and derivative instruments	(47.3)	(24.3)
Interest on swaps and debt under fair value option	23.5	15.4
Net pension interest income	(7.1)	(10.2)
Capitalised borrowing costs	(39.7)	(29.2)
Underlying net finance expense	(251.8)	(209.5)
Profit before tax		
Share of profits of joint ventures	2.3	3.8
Profit before tax per published results	457.5	470.2
Adjustments:		
Flooding incidents	1.7	1.5
Non-household retail market reform	1.0	5.8
Restructuring costs	6.0	10.1
Net fair value gains on debt and derivative instruments	(47.3)	(24.3)
Interest on swaps and debt under fair value option	23.5	15.4
Net pension interest income	(7.1)	(10.2)
Capitalised borrowing costs	(39.7)	(29.2)
Profit on disposal of business	-	(22.1)
Underlying profit before tax	395.6	417.2
Profit after tax		
Underlying profit before tax	395.6	417.2
Reported tax charge	(82.3)	(14.0)
Deferred tax credit – change in tax rate	-	(58.2)
Agreement of prior years' tax matters	0.4	(15.5)
Tax in respect of adjustments to underlying profit before tax	11.8	6.2
Underlying profit after tax	325.5	335.7

Strategic report

Principal risks and uncertainties

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

We continue to focus on creating sustainable value by delivering a high quality customer service, at the lowest sustainable cost, while acting in a responsible manner at every level within our organisation. In our day-to-day operations we encounter a wide variety of risks which can challenge the quality, cost-effectiveness and timescales for the delivery of our aims and ambitions. We identify and plan for mitigation of these risks under our established risk management framework which includes:

- an enterprise-wide approach to risk management;
- oversight and control of risk through a well-established governance and reporting structure;
- a risk assessment and management process which is aligned to ISO 31000:2009; and
- training materials, accessible policies and guidance to help our people to identify and manage risk in a consistent manner.

Key features and developments

Key developments in the last 12 months include a maturing of and increased formalisation of our risk appetite framework. Our framework supports our assessment of the extent of risk we are willing to take based on obligations, stakeholders' requirements and the company's capacity and capability to manage risk. By doing this we aim to influence the target position for individual risks underpinning the principal risks through improved consistency. This approach also enables better benchmarking of individual risks against the appetite limits and boundaries. We have also sought to make an incremental governance improvement in our sign-off processes for all risks and also in relation to the wholesale risk and resilience board and the core risk team meetings which focus on long-term resilience. Associated with this is a focus on asset health and operational hazard risk assessment in advance of and beyond PR19. This supports our understanding of the long-term risk profile of our asset base and improves our capability to deliver the most cost-effective and proportionate risk management response as a result.

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

Political and regulatory risk and uncertainty feature prominently within the profile, notably with the outcome of PR19 which is expected to be even tougher than previous price reviews. The possibility of 'Renationalisation' is a key area of uncertainty as is the opening up to competition of wholesale operations (including the current focus on possible competition in bioresources and water abstraction) and the potential for competition covering domestic retail activities.

Our operations continue to be UK-based, but the potential impacts of 'Brexit' remain under review and have been reported to the group board. In common with other UK companies, a significant issue is the uncertainty surrounding the effects of the Brexit deal that the UK Government ultimately delivers. Our review has considered the availability of European funding, the price of goods and services, exchange rate impacts, possible impacts on our ability to collect cash were there to be an economic downturn and the effect of any potential inflationary shift outside current predicted parameters. We continue to keep this area under review.

Following the launch of non-household retail competition in April 2017, we have continued to monitor our operations within the market to review compliance risks and ensure that we continue to operate in a manner that complements and promotes the 'level playing field'.

From an operational risk perspective, the dominance of the penalty element of Ofwat's outcome delivery incentive mechanism and the effect following changes to the Environmental Sentencing Guidelines are key features of evolving exposure. Reputationally, our core operations/service provision (notably water service)

Strategic report

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 continue to adapt to and plan for climate change and its significant and permanent impacts on the water cycle, our operations and the broader operating environment. This includes consideration of the long-term viability of water and wastewater services such as water abstraction, drinking water supply and treatment capability, drainage and sewer capacity, wastewater treatment and its discharge efficiency and effectiveness. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) support and reinforce the need to consider climate-related risks and uncertainties. These continue to be factored into risk management and the likely effects of future changes are a critical consideration in our long and medium-term risk, operational and financial planning. Our water service and wastewater service risks summarised below also reflect current key risks including the potential for extreme weather and climate change.

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. While our directors remain of the opinion that the likelihood of a material adverse impact on the group’s financial position is remote, based on the facts currently known to us and the provisions in our statement of financial position, the following two cases are worthy of note:

- 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. There have been no material developments in this matter over the last 12 months; and

- In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water Limited (UUW) in respect of UUW’s discharges of water and treated effluent into the canal. While 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:

- Potential Renationalisation of the water sector
- 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 to the Consumer Prices Index for regulatory indexation
- Brexit

Strategic report

Potential impacts

- A potential increase in costs of administration, reduced income, margin and greater variability of returns
- A potential loss of confidence of equity investors and challenging debt market conditions creating funding pressures given the need to raise finance and refinance debt on an on-going basis
- The possibility on a potential Renationalisation that the business is acquired below fair value

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. We keep customers and the public informed. We also provide information to the government, regulators, customers and the public as appropriate to help them to make informed decisions.

2. Compliance risk

A failure to provide a secure supply of clean, safe drinking water and the potential for negative impact on public confidence in water supply.

Current key risks, issues or areas of uncertainty include:

- Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market
- Level playing field requirements in relation to the non-household retail market
- Current material litigation
- Higher fine levels for environmental offences
- Introduction of material pieces of legislation e.g. the General Data Protection Regulation

Potential impacts

The potential to receive penalties of up to ten per cent of relevant turnover and ultimately revocation of our licence or the appointment of a special administrator.

Control mitigation

Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Allowance 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:

- Population growth
- Extreme weather and climate change
- Meeting infrastructure investment requirements
- Expected change to the abstraction licensing regime
- Catchment management

Strategic report

Potential impacts

- The potential for public health issues associated with poor water quality
- The potential for supply interruptions that could affect large populations within the region for long durations
- The potential for serious pollution (including sewer flooding) leading to disruption to the public, businesses and the environment (wildlife, fish and natural habitats) resulting in fines and reputational damage

Control mitigation

Mitigation is provided through core business processes, including centralised planning and control, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Optimisation of operational and maintenance tasks together with targeted capital interventions help to ensure services to customers are maintained. Our 25-year Water Resources Management Plan defines our strategy to achieve a long-term, best-value and sustainable plan for water supplies in the North West including consideration of over 20 different climate change scenarios including a 2°C or lower global warming scenario (assessing systems resilience). We continue to develop innovative solutions and invest in resilience to further support the delivery of water and wastewater services in the long-term.

4. Retail and commercial risk

Failing 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
- Competition in the water and wastewater market and competitor positioning
- Brexit
- Non-household retail competition and the ability to treat other participants equally

Potential impacts

- The potential for significant regulatory penalties and long-term reputational damage associated with poor customer satisfaction
- The potential for a significant increase in the bad debt charge, reducing profitability

Control mitigation

For domestic retail there are a wide range of initiatives and activities focused on improving customer satisfaction, including proactive incident communication, complaints handling and use of appropriate tariffs. Bad debt risk is managed through the adoption of best practice collection techniques, segmentation of customers based on their credit risk profile and the use of data sharing to better understand customers' circumstances to determine the most appropriate collection and support activities. Our wholesale business maintains processes, systems, data and organisational capacity and capability to deal fairly with market participants and the central market operator in the Business Retail market in order to generate and collect revenue.

5. Financial risk

Potential inability to finance the business appropriately.

Current key risks, issues or areas of uncertainty include:

- Stability of financial institutions and the world economy

Strategic report

- Economic uncertainty
- Inflation/deflation
- Financial market conditions, interest rates and funding costs
- Brexit

Potential impacts

- The potential for worse credit ratings, associated funding costs or reduced access to debt capital markets leading to lower liquidity and adversely impacting the economic return on the regulatory capital value (RCV)
- The potential for a worsening of the pension scheme funding position leading to a requirement for the group to make additional contributions

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 manage the impact of market fluctuations for inflation, interest rates and 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. Supply chain and 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
- Delivery of solutions
- Technical quality and innovation
- Brexit

Potential impacts

Potential failure to meet our obligations and customer outcomes resulting in an impact at future price reviews, negative reputational impact with customers and regulators.

Control mitigation

Supply chain management is utilised to deliver an end-to-end contract management service, including contract strategy, tendering and category management, which provides a risk-based approach and relationship management programmes for suppliers. We prioritise our investment programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service providers 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.

7. Resource risk

Failing to provide appropriate resources (human, technological or physical resource) required to support business activity.

Strategic report

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 potential inability to recruit and retain knowledge/expertise
- The potential inability to respond and recover due to ineffective non-resilient business activity

Control mitigation

Developing our people to have the right skills and knowledge, combined with delivering effective technology 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.

8. Security risk

Potential for malicious activity (physical or technological) against people, assets or operations.

Current key risks, issues or areas of uncertainty include:

- Cybercrime
- Terrorism
- Fraud
- Ownership and operation of National Infrastructure and Critical National Infrastructure

Potential impacts

- The potential for loss of data/information and the consequent effect on service provision
- The potential for catastrophic damage to UU property, infrastructure and non-infrastructure and the consequent effect on service provision

Control mitigation

Physical and technological security measures and awareness training combined with strong governance and inspection regimes which aim to protect infrastructure, assets and operational capability. Externally, we work closely with our industry peers, the Centre for the Protection of National Infrastructure (CPNI), the National Cyber Security Centre (NCSC) and Defra to shape the sector approach to security, particularly cyber security, and to understand how we can best deliver the appropriate levels of protection to our business. 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 our licence 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 harm to people (employees, contractors or the public) and the environment.

Current key risks, issues or areas of uncertainty include:

- Impounding reservoirs containing significant volumes of water

Strategic report

- Other critical asset failure
- Process safety
- Excavation, tunnelling and construction work
- Working with chemicals
- Fluvial and coastal flooding

Potential impacts

- The potential for serious injury or loss of life in remote, extreme circumstances
- The potential for catastrophic damage to private, public or commercial property/infrastructure including the consequent effect on water and wastewater service provision
- The potential for serious impact to wildlife, fish or natural habitats resulting in significant fines and reputational damage

Control mitigation

We have developed a strong health and safety culture where ‘nothing we do at United Utilities is worth getting hurt for’, supported by strong governance and management systems certified to OHSAS 18001. We actively seek to improve health, safety and wellbeing across the group through targeted improvements and benchmarking against our peers. Also certified to ISO 14001, we seek to protect and improve the environment through the responsible delivery of our services. This includes helping to support rare species and habitats through targeted engagement and activity and commitment to reducing our carbon emissions by designing out waste from our operations, generating our own energy and looking at ways to reduce our use of raw materials. We also recognise the impact the environment can have on our service provision with extreme weather and climate change being integrated into our risk, planning and decision-making processes.

The Strategic report was approved by the board on 12 June 2018 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 2018.

Profit and dividends

The results for the year, set out in the consolidated income statement on page 40 show that profit for the year after tax was £375.2 million (2017: £456.2 million).

The directors have not recommended a final ordinary dividend (2017: £nil). Interim ordinary dividends of £267.1 million (2017: £263.1 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 £21,662 (2017:£11,298) as part of this process, the increase on the previous year as a result of a parliamentary reception hosted by the company to engage parliamentary stakeholders on its business plan development. At the 2017 AGM, an authority was taken to cover such expenditure.

A similar resolution will be put forward at the 2018 UUG 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 £1.2 million in the year ended 31 March 2018 (2017: £2.3 million).

Carbon footprint

The group is committed to reducing its carbon footprint and increasing its generation of renewable energy. In 2017/18, the group's carbon footprint totalled 391,640 tonnes of carbon dioxide equivalent, which is a 33 per cent reduction over the last 10 years. For further information please visit *unitedutilities.com/corporate/responsibility/environment/climate-change/*.

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 2018.

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 46.

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 our disabled employees can be found in the ‘People’ section on page 7. The company’s business principles make clear how the company and all our employees must seek to act with integrity and fairness and observe legal requirements. Anyone with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or through a confidential telephone line.

Importance is placed on strengthening employees’ engagement, measuring their views annually, then taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information to enable them to understand the financial and economic factors affecting the company’s performance. The board encourages employees to own shares in the company through the all employee share incentive plan (ShareBuy). For further information on our average number of employees during the year, go to note 2 on page 54.

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 2018, 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 20 to the financial statements on page 69.

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 23 to 29. 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 86 of the 2018 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
12 June 2018

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 and the Group and parent Company financial statements in accordance with applicable law and regulations.

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

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

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 are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report, Directors' Report, and Corporate Governance Statement that complies with that law and those regulations.

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

We confirm that to the best of our knowledge:

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

Signed on behalf of the board:

JR Houlden
Chief Financial Officer
12 June 2018

Independent auditor's report

to the members of United Utilities PLC

1. Our opinion is unmodified

We have audited the financial statements of United Utilities PLC ("the Company") for the year ended 31 March 2018 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated and company statements of financial position, the Consolidated and company statements of changes in equity, the Consolidated and company statements of cashflows, and the related notes, including the accounting policies on pages 46 to 52 and 98 to 105.

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 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the directors on 9 October 2017. The period of total uninterrupted engagement is for the seven financial years ended 31 March 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Revenue recognition and provision for household customer debt Revenue not recognised: £20.3 million (2017: £28.3 million) Provision for customer debts: £63.4 million (2017: £85.4 million) *Refer to pages 47 and 98 (accounting policy), and page 63 to 64 (financial disclosures).*	
The Risk **Subjective estimation:**	**Our Response** **Our procedures included:** ***Accounting analysis* –** Assessing whether appropriate revenue recognition policies are

Independent auditor's report

to the members of United Utilities PLC

Household revenue recognition and provision for household customer debts are key areas of judgement, particularly in relation to: - identifying properties where there is little prospect cash will be received for revenue that has been billed due to either the occupier not being able to be identified or a past history of non-payment of bills relating to that property; and - assessing the recoverability of trade debtors.	applied through comparison with relevant accounting standards including the policy of not recognising revenue where it is not probable that cash will be received; ***Control observation* –** Testing the group's controls over revenue recognition and provision for customer debts, including reconciliations between sales and cash receipts systems and the general ledger; ***Methodology choice* –** Assessing the appropriateness of the customer debt provisioning policy based on historical cash collections, credits, re-bills and write-off information; and ***Assessing transparency* –** Assessing the adequacy of the group's disclosures of its revenue recognition and customer debt provisioning policies, including the judgement involved in recording revenue and estimation uncertainty of the bad debt provision. **Our results:** - In respect of the recognition of revenue only where it is probable that economic benefits/cash will be received, we found the amount of revenue recognised to be appropriate; and - From the evidence obtained, we considered the level of bad debt provisioning to be acceptable
Capital expenditure £741.3 million (2017: £717.9 million) *Refer to pages 47 to 48 and 100 to 101 (accounting policy), and page 60 (financial disclosures).*	
The Risk **Subjective classification:** The group has a substantial capital programme which has been agreed with the Water Services Regulation Authority (Ofwat) and therefore incurs significant annual expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. The determination of in year project costs as capital or operating expenditure is inherently judgemental. Costs capitalised include an allocation of overhead costs, relating to the proportion of time spent by support function staff, which is also inherently judgemental.	**Our Response** **Our procedures included:** ***Accounting analysis*** – Assessing the group's capitalisation policy for compliance with relevant accounting standards; ***Control observation*** – Testing controls over the application of the policy in the period including review of project business case submissions, and attending a sample of capital approval meetings to observe the judgements made and evaluating the documented conclusions; ***Tests of details*** – Critically assessing the costs capitalised for a sample of projects against the capitalisation policy; ***Tests of details*** – Identify and assess the impact of changing capitalisation rates for all existing projects;

Independent auditor's report

to the members of United Utilities PLC

<table>
<tr><td></td><td> Historical comparisons – Critically assess the proportion of overhead costs by business area which are capitalised using historical comparisons and expected changes based upon corroborated enquiry and our sector knowledge; and Assessing transparency – Assessing the adequacy of the group's disclosures of its capitalisation policy and other related disclosures. Our results: We found the group's treatment of expenditure as capital or operating to be acceptable. </td></tr>
<tr><td colspan="2">Retirement benefit obligation valuation
£3,498.7 million (2017: £3,615.5 million)
Refer to pages 48 and 104 (accounting policy), and pages 87 to 94 (financial disclosures).</td></tr>
<tr><td> The Risk Estimation in valuation of retirement obligations: The group's retirement benefit surplus is the difference between the fair value of the pension assets and the retirement benefit obligation. Significant estimates are made in valuing the group's retirement benefit obligation. Small changes in assumptions and estimates used to value the group's pension obligation would have a significant effect on the group's financial position. </td><td> Our Response Our procedures included: Benchmarking assumptions – Challenging the key assumptions supporting the group's retirement benefit obligations valuation with input from our own actuarial specialists, including comparing the discount rate, inflation rate and life expectancy assumptions used against externally derived data. We performed a comparison of key assumptions against our own benchmark ranges which are derived from available data as well as comparing against those used by other companies reporting on the same period; and Assessing transparency – Assessing the group's disclosure in respect of the sensitivity of the liabilities to changes in the key assumptions. Our results: The results of our testing were satisfactory and we found the obligation recognised to be acceptable. </td></tr>
<tr><td colspan="2"> <u>Risk relevant to Parent Company and the Group</u> Water plus joint venture investment and loans carrying value
£39.3 million investment in joint venture and £135.8 million loans to joint venture (2017: £39.1 million and £118.5 million respectively)
Refer to pages 48 and 98 and 102 to 103 (accounting policy), and pages 95 to 97 (financial disclosures). </td></tr>
<tr><td> The Risk Forecast-based estimate valuation: The group's investment in the equity and loans to Water Plus are significant. The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash </td><td> Our procedures included: Benchmarking assumptions – Evaluating assumptions used, in particular those relating to discount rate, terminal growth rate, and the normalised level of working capital in the business, using our own valuation specialist and comparing to externally derived data; </td></tr>
</table>

Independent auditor's report

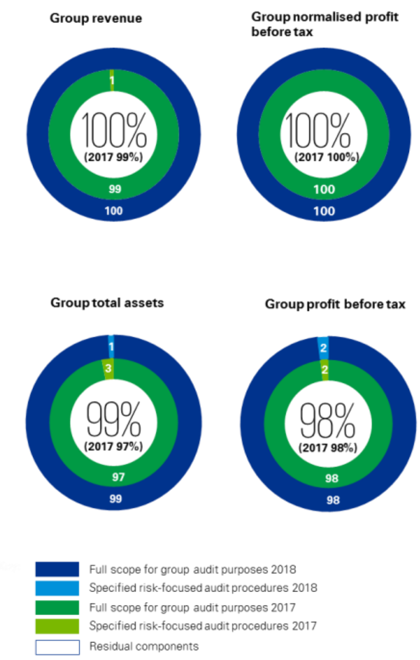
to the members of United Utilities PLC

flows. The estimate of the investment in Water Plus is also sensitive to the discount rate used.	***Sensitivity analysis* –** Performing sensitivity analysis on the assumptions noted above; and ***Assessing transparency* –** Assessing whether the group's disclosures are appropriate. **Our results:** We found the resulting estimate of the recoverable amount of the total investment and loans to Water Plus joint venture to be acceptable.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £18.51 million (2017: £18.51m), determined with reference to a benchmark of group profit before tax, normalised to exclude net fair value gains or losses on debt and derivative instruments in disclosed in note 5, of £410.2 million, of which it represents 4.5% (2017: 4.1%). Materiality for the parent company financial statements as a whole was set at £18.5 million (2017: £18.5 million), determined with reference to a benchmark of company net assets of £6,038.0 million, of which it represents 3.1% (2017: 3.1%). We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the group's 33 (2017: 33) reporting components, we subjected five (2017: five) to full scope audits for group purposes.



The remaining two per cent of group profit before tax and one per cent of total group assets is represented by 28 of reporting components, none of which individually represented more than two per cent of any of total group revenue, group profit before tax or total group assets.

The group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The group team approved the component materiality of £2.5 million to £18.5 million, having regard to the mix of size and risk profile of the group across the components. The work on one of the five components (2017: one of the five components) was performed by component auditors and the rest, including the audit of the parent company, was performed by the group team. The group team performed procedures on the items excluded from normalised group profit before tax.

Independent auditor's report

to the members of United Utilities PLC

The group team visited no (2017: one) component locations (2017: Stoke). To assess the audit risk and strategy, telephone conference meetings were also held with the component auditor that was not physically visited. At these meetings, the findings reported to the group team were discussed in more detail, and any further work required by the group team was then performed by the component auditor.

4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements 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.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 33, the directors are responsible for the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern, and using the going concern basis of accounting unless they either intend to liquidate the Group or parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue

Independent auditor's report

to the members of United Utilities PLC

our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience and through discussion with the directors and other management (as required by auditing standards).

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statement items.

In addition, we considered the impact of laws and regulations in the specific areas of environmental law, health and safety, anti-bribery, employment law, regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the group's activities and its legal form. With the exception of any known or possible non-compliance and, as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory and legal correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related financial statement items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and whom we owe our responsibilities

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.

William Meredith
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
St Peter's Square, Manchester M2 3AE
12 June 2018

Consolidated income statement

for the years ended 31 March

	Note	2018 £m	2017 £m
Revenue	1	1,735.8	1,704.0
Employee benefits expense	2	(153.5)	(151.9)
Other operating costs	3	(423.4)	(435.1)
Other income	3	3.8	4.2
Depreciation and amortisation expense	3	(376.8)	(364.9)
Infrastructure renewals expenditure		(149.5)	(150.8)
Total operating expenses		(1,099.4)	(1,098.5)
Operating profit		636.4	605.5
Investment income	4	37.4	41.5
Finance expense	5	(218.6)	(202.7)
Investment income and finance expense		(181.2)	(161.2)
Profit on disposal of business		-	22.1
Share of profits of joint ventures	10	2.3	3.8
Profit before tax		457.5	470.2
Current tax charge	6	(23.5)	(37.0)
Deferred tax charge	6	(58.8)	(35.2)
Deferred tax credit – change in tax rate	6	-	58.2
Tax	6	(82.3)	(14.0)
Profit after tax		375.2	456.2

All of the results shown above relate to continuing operations.

Consolidated statement of comprehensive income

for the years ended 31 March

	Note	2018 £m	2017 £m
Profit after tax		375.2	456.2
Other comprehensive income			
Remeasurement gains/(losses) on defined benefit pension schemes	16	50.2	(76.7)
Tax on items taken directly to equity	6	(8.5)	17.3
Foreign exchange adjustments		0.2	3.7
Total comprehensive income		417.1	400.5

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

Consolidated and company statements of financial position

at 31 March

			Group		Company
		2018	2017	2018	2017
	Note	£m	£m	£m	£m
ASSETS					
Non-current assets					
Property, plant and equipment	8	10,790.5	10,405.5	-	-
Intangible assets	9	197.7	187.7	-	-
Interests in joint ventures	10	75.2	75.2	39.1	39.1
Investments	11	7.1	9.0	4,176.0	4,181.2
Trade and other receivables	13	1,831.4	1,777.7	1,726.2	1,674.4
Retirement benefit surplus	16	344.2	247.5	80.1	53.0
Derivative financial instruments	A4	297.8	731.0	-	187.0
		13,543.9	13,433.6	6,021.4	6,134.7
Current assets					
Inventories	12	16.8	22.4	-	-
Trade and other receivables	13	270.0	312.6	1,611.3	1,612.6
Current tax asset		24.5	7.1	-	-
Cash and short-term deposits	14	510.0	247.8	9.6	50.2
Derivative financial instruments	A4	337.7	76.7	118.7	0.3
		1,159.0	666.6	1,739.6	1,663.1
Total assets		14,702.9	14,100.2	7,761.0	7,797.8
LIABILITIES					
Non-current liabilities					
Trade and other payables	19	(642.7)	(589.3)	-	-
Borrowings	15	(7,072.8)	(7,058.4)	(282.7)	(815.8)
Deferred tax liabilities	17	(1,098.8)	(1,031.5)	(13.5)	(8.6)
Derivative financial instruments	A4	(96.8)	(235.5)	-	-
		(8,911.1)	(8,914.7)	(296.2)	(824.4)
Current liabilities					
Trade and other payables	19	(285.6)	(329.1)	(94.4)	(99.1)
Borrowings	15	(901.0)	(386.8)	(1,332.4)	(907.8)
Provisions	18	(22.1)	(26.5)	-	-
Derivative financial instruments	A4	(4.2)	(14.2)	-	-
		(1,212.9)	(756.6)	(1,426.8)	(1,006.9)
Total liabilities		(10,124.0)	(9,671.3)	(1,723.0)	(1,831.3)
Total net assets		4,578.9	4,428.9	6,038.0	5,966.5
EQUITY					
Capital and reserves attributable to equity holders of the company					
Share capital	20	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		(1.8)	(2.0)	-	-
Retained earnings		2,268.9	2,119.1	3,726.2	3,654.7
Shareholders' equity		4,578.9	4,428.9	6,038.0	5,966.5

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 12 June 2018, and signed on its behalf by:

JR Houlden
Chief Financial Officer

Consolidated statement of changes in equity

for the years ended 31 March

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
Group					
At 1 April 2017	881.8	1,430.0	(2.0)	2,119.1	4,428.9
Profit after tax	-	-	-	375.2	375.2
Other comprehensive income					
Remeasurement gains on defined benefit pension schemes (see note 16)	-	-	-	50.2	50.2
Tax on items taken directly to equity (see note 6)	-	-	-	(8.5)	(8.5)
Foreign exchange adjustments	-	-	0.2	-	0.2
Total comprehensive income	-	-	0.2	416.9	417.1
Dividends (see note 7)	-	-	-	(267.1)	(267.1)
At 31 March 2018	881.8	1,430.0	(1.8)	2,268.9	4,578.9

	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 16)	-	-	-	(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

Company statement of changes in equity

for the years ended 31 March

	Share capital £m	Share premium account £m	Retained earnings £m	Total £m
Company				
At 1 April 2017	881.8	1,430.0	3,654.7	5,966.5
Profit after tax	-	-	325.7	325.7
Other comprehensive income				
Remeasurement gains on defined benefit pension schemes (see note 16)	-	-	15.6	15.6
Tax on items taken directly to equity (see note 6)	-	-	(2.7)	(2.7)
Total comprehensive income	**-**	**-**	338.6	338.6
Dividends (see note 7)	-	-	(267.1)	(267.1)
At 31 March 2018	881.8	1,430.0	3,726.2	6,038.0

	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 16)	-	-	(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

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 £325.7 million (2017: £347.1 million).

Consolidated and company statements of cash flows

for the years ended 31 March

		Group		Company	
		2018	2017	2018	2017
	Note	£m	£m	£m	£m
Operating activities					
Cash generated from operations	A1	960.7	981.7	301.0	325.7
Interest paid		(144.6)	(161.0)	(23.5)	(29.7)
Interest received and similar income		30.9	33.4	1.5	1.2
Tax paid		(35.5)	(42.4)	(33.9)	(42.4)
Tax received		-	1.2	-	-
Net cash generated from operating activities		811.5	812.9	245.1	254.8
Investing activities					
Purchase of property, plant and equipment		(698.6)	(672.4)	-	-
Purchase of intangible assets		(36.1)	(52.4)	-	-
Proceeds from sale of property, plant and equipment		1.1	4.1	-	-
Grants and contributions received	19	23.7	29.0	-	-
Loans to joint ventures	A6	(26.5)	(109.0)	-	-
Investment in joint ventures		-	(13.5)	-	(13.5)
Proceeds from investments	11	1.0	0.9	-	-
Proceeds from disposal of business		8.9	3.3	-	3.3
Dividends received from joint ventures	10	3.3	5.4	-	-
Net cash used in investing activities		(723.2)	(804.6)	-	(10.2)
Financing activities					
Proceeds from borrowings		801.7	741.8	36.6	95.7
Repayment of borrowings		(345.9)	(448.7)	(55.2)	(34.3)
Dividends paid to equity holders of the company	7	(267.1)	(263.1)	(267.1)	(263.1)
Net cash generated from/(used in) financing activities		188.7	30.0	(285.7)	(201.7)
Net increase/(decrease) in cash and cash equivalents		277.0	38.3	(40.6)	42.9
Cash and cash equivalents at beginning of the year		220.9	182.6	50.2	7.3
Cash and cash equivalents at end of the year	14	497.9	220.9	9.6	50.2

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. 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 2018, have had no material impact on the group's financial statements.

- Amendments to IAS 12 'Income Taxes', clarifying how to account for deferred tax assets related to debt instruments measured at fair value;
- Amendments to IAS 7 'Statement of Cash Flows'; requiring disclosures that enable evaluation of changes in liabilities arising from financing activities; and
- Improvements to IFRS (2016) (Amendment to IFRS 12 'Disclosure of Interests in Other Entities', effective date 1 January 2018).

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. Management considers that where customers have not paid their bills within the last two years, or have not cleared previously outstanding arrears aged more than two years, collectability is not deemed to be reasonably assured, and therefore amounts billed to these customers are not recognised as revenue. This resulted in £20.3 million of amounts billed not being recognised as revenue during the year (net of cash receipts and credits). Had management made an alternative judgement that collectability was not reasonably assured where customers had not paid within one year or within three years, or had not cleared previously outstanding arrears within these time frames, this would have resulted in £0.9 million of revenue not being recognised during the year or £9.4 million additional revenue being recognised during the year respectively. 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. At 31 March 2018 the allowance for doubtful receivables of £63.4 million was supported by a six-year cash collection projection. Based on a five-year or seven-year cash collection projection the allowance for doubtful receivables would have been £64.3 million or £62.4 million respectively.

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. Revenue recognised for unbilled amounts for these customers at 31 March 2018 was £40.2 million. Had actual consumption been five per cent higher or lower than the estimate of units supplied this would have resulted in revenue recognised for unbilled amounts being £3.8 million higher or lower respectively. 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. Enhancement spend was 30 per cent of total spend in relation to infrastructure assets during the year. A change of +/- one per cent would have resulted in £2.3 million less/more expenditure being charged to the income statement during the period. 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. Support costs allocated to PPE represent 58 per cent of total support costs. A change in allocation of +/- one per cent would have resulted in £0.9 million less/more expenditure being charged to the income statement during the period.

Accounting estimate - the estimated useful economic lives of PPE and intangible assets is 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

Accounting policies

the significance of PPE and intangibles investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively. As such this is a key source of estimation uncertainty, although historically few changes to estimated useful economic lives have been required. The depreciation and amortisation expense for the year was £376.8 million. A 10 per cent increase in average asset lives would have resulted in a £33.6 million reduction in this figure and a 10 per cent decrease in average asset lives would have resulted in a £42.3 million increase in this figure.

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. Profit before tax and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions. It should be noted that actual rates may differ from the assumptions used due to changing market and economic conditions and longer or shorter lives of participants and, as such, this represents a key source of estimation uncertainty. Sensitivities in respect of the assumptions used during the year are disclosed in note A5.

Joint ventures

Accounting estimate - the group has interests relating to its joint ventures in the form of equity investments and loans receivable, the recoverability of which are considered with reference to the present value of the estimated future cash flows of the joint ventures. Management tests whether any impairment exists in relation to the equity investments and loans receivable if adverse changes in conditions associated with the joint ventures suggest that this is appropriate. The estimated present value of these future cash flows is sensitive to the discount rate and terminal growth rate used in the calculation, together with the normalised level of working capital in the joint venture, all of which require management judgement. Testing of the carrying value has been performed during the year, which has involved a number of scenarios being modelled. Based on this testing, management believes there is sufficient headroom to support the carrying value of the group's interests in joint ventures, although it is possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumptions used could require a material adjustment to the carrying amount of assets.

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. Sensitivities relating to derivative financial instruments are included in note A4.

Provisions and contingencies

Accounting estimate - 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. 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. The provisions in respect of these claims, based on management's best estimates, totalled £19.5 million as at 31 March 2018 as set out in the "Other" category in note 18; due to an inherent level of estimation uncertainty management estimate that there is an 80 per cent probability that the outcomes of these items will fall within a range of £10 million to £25 million. Matters that either are possible obligations or do not

Accounting policies

meet the recognition criteria for a provision are disclosed as contingent liabilities in note 22, 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, a £24.0 million loss would have been recognised in other comprehensive income rather than within the income statement.

The new standard has moved to a principles-based approach to align hedge accounting to the risk management activities of the entity, broadening the scope of what can be included within a hedge relationship. This change will see the requirement for cross currency basis spread adjustments to be incorporated in the test for the effectiveness of a hedge to be removed. The portion of the change in fair value due to changes in the cross currency basis spread will be recognised in other comprehensive income rather than within profit or loss. If the standard had been adopted in the current year, a £8.2 million gain would have been recognised in other comprehensive income rather than within the income statement.

The changes in hedge accounting may present increased opportunities in the future to put non-financial risks into hedge relationships, however we do not expect this to have any material impact on the financial statements in the period of initial application.

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. Consequently, judgement will be required in forming an expectation of future credit losses, particularly in relation to the group's trade receivable balances. The group currently employs a model that uses historic cash collection rates to form an expectation of the estimated recoverability of trade receivables at a point in time as this is the best information available on which an expectation can be formed. As such, there will be no significant change to the model currently used although the group will continue to explore ways in which it might be further refined, and will take into consideration any significant economic changes that may have a bearing on expected credit losses. This is not expected to have a material impact on the overall level of allowances for bad and doubtful receivables.

The group is not required to restate 2018 comparative information for balances affected by the adoption of IFRS 9 in the year of transition.

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'. The standard requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation.

Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgement is therefore required in identifying the services contained within the contract and the customer with who the

Accounting policies

contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

There are two main areas of the group's activities that will be impacted by the adoption of IFRS 15:

- Core water and wastewater services, accounting for more than 97 per cent of the group's revenue under current accounting standards, and

- Capital income streams accounting for less than 2 per cent of the group's revenue in the income statement under current accounting standards, but where around £600 million of balances are currently included within deferred grants and contributions on the statement of financial position.

Other ancillary revenue streams are not expected to be significantly impacted, and no significant judgements are required in relation to these.

Core water and wastewater services

These services relate to: (i) the supply of clean water; and (ii) the removal and treatment of wastewater, with provision of each of these services deemed to be a distinct performance obligation under the contract with customers, though following the same pattern of transfer to the customer who simultaneously receives and consumes both of these services over time. No significant judgements are required in identifying customers of these services. In accordance with IFRS 15, revenue relating to these activities will be recognised over time as these performance obligations are satisfied. The adoption of the new standard is not expected to have any impact on the timing and amount of revenue recognised in these services.

Capital income

Capital income refers to the group's income streams relating to transactions, typically with property developers, which impact the group's capital network assets. It should be noted that this area remains under active consideration within the industry and the accounting profession more broadly, and that the accounting treatment ultimately adopted by the group in this area could therefore be impacted by the outcome of these ongoing discussions. We set out below, our current assessment of the impact of IRFS 15 in relation to the transactions.

There are two categories of capital income, both of which will be impacted by the adoption of IFRS 15:

- Diversions relating to the relocation, of water and wastewater assets, and

- Activities that facilitate the creation of an authorised connection through which properties can obtain water and wastewater services.

The adoption of IFRS 15 will not result in any net income statement impact relating to diversions, where income is currently recognised in line with the completion of diversion work. However, whereas this income is currently included in the income statement as a credit within infrastructure renewals expenditure (IRE) due to it representing a contribution towards these costs, under IFRS 15 it will be recognised within revenue resulting in an increase in both the revenue and IRE expense balances. If the standard had been adopted in the current year this would have resulted in revenue and IRE both increasing by £7.9 million.

Significant judgement is required in relation to accounting for activities that facilitate an authorised network connection through which water and wastewater services can be delivered. Establishing such an authorised connection can involve a number of activities performed opposite developers which are considered to be neither separable nor distinct and instead form a bundle of activities necessary to establish an authorised connection from which network access can be obtained and water and wastewater services can be provided. These are considered to form part of the group's ordinary activities associated with the operation, maintenance and expansion of a water and wastewater network, and because they are deemed to result in an exchange transaction we have determined that they fall within the scope of IFRS 15 as transactions arising from contracts with customers.

Accounting policies

In addition, as the group has a legal obligation to keep a connection in place for as long as a property requires water and wastewater services these initial connection activities are deemed to result in a broader ongoing performance obligation that is not distinct from the ongoing supply of water and wastewater services. The right to benefit from this connection and obtain water and wastewater services through it is deemed to be transferable from the initial developer to subsequent occupants of a connected property. Accordingly, under IFRS 15 the element of the performance obligation associated with the connection activities will be deemed to be satisfied over the period of time that water and wastewater services are expected to be provided through the connection, compared with the current treatment under which deferred amounts are released to the income statement of the useful economic life of the related assets or, for certain items, immediately to the income statement. This estimated period is a matter of judgement. We estimate that an average connection will be in place for a period of around 60 years and therefore revenue associated with connection activities will be recognised evenly over this period.

We intend to apply IFRS 15 retrospectively with the cumulative effect of initially applying the standard recognised as an adjustment to the opening retained earnings balance at the date of initial application. The standard permits that, where this approach is used, contracts that have been completed in accordance with current accounting standards at the date of initial application will not be restated on an IFRS 15 basis.

Based on the deferred balance held on the statement of financial position relating to connection activities where the contract has not been completed as at 31 March 2018, the adjustment to retained earnings on the transition date of 1 April 2018 is expected to be a reduction in deferred grants and contributions and a corresponding increase in retained earnings of £2.7 million. In the year of adoption, revenue of £12.3 million is expected to be recognised in the income statement in relation to the updated deferred balances held on the statement of financial position relating to connection activities at 1 April 2018, compared with £8.9 million under current accounting standards. In addition, around £0.1 million of revenue is expected to be recognised in relation to balances that will be newly deferred under IFRS 15, compared with around £4 million that would have been expected to be recognised in the year ending 31 March 2019 under accounting standards adopted at 31 March 2018.

The net effect of these changes is that the total amount of annual revenue recognised in relation to these items is expected to fall by around £0.5 million as a result of the adoption of IFRS 15, compared with the group's treatment under accounting standards adopted at the reporting date.

IFRS 16 'Leases'

The standard is effective for periods commencing on or after 1 January 2019. Under the provisions of the standard most leases, including the majority of those previously classified as operating leases, will be brought onto the statement of financial position, as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 'Property, Plant and Equipment' and the liability increased for the accretion of interest and reduced by lease payments.

The key judgements associated with adoption of this standard relate to the identification and classification of contracts containing a lease within the scope of IFRS 16, and the discount rate to use in calculating the present value of future lease payments on which the reported lease liability and right-of-use asset is based when the rate is not implicit in the lease contract.

Work to ensure the correct identification and classification of leases remains ongoing and will continue over the course of the coming year.

The discount rate is a key determinant in calculating the present value of future lease payments. The appropriate rate to use remains an area of active discussion, the outcome of which is likely to have a material impact on the valuation of the right-of-use asset and lease liability on adoption. Accordingly, as we do not yet have clarification on this point, we have not sought to quantify the impact of adoption at this stage.

Accounting policies

We intend to use the modified retrospective transitional approach permitted by the standard in which the right-of-use asset and lease liability brought onto the balance sheet will be based on the present value of future lease payments at the adoption date calculated using the appropriate discount rate. The discount rate will be based on the company’s incremental cost of borrowing at the point of adoption where the interest rate is not implicit in the lease contract. As such, the impact on adoption will be sensitive to the group’s incremental borrowing costs as at the 1 April 2019 adoption 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 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

	2018 £m	2017 £m
Salaries	1.8	1.7
Benefits	0.5	0.4
Bonus	0.9	0.8
Share-based payment charge	1.9	1.8
	5.1	4.7

Included within the above are aggregate emoluments of £2.3 million (2017: £2.2 million) in respect of the highest paid director.

No directors accrued benefits under defined benefit schemes during the current year (2017: no directors). All directors opted for a cash allowance in lieu of their company pension scheme entitlement (2017: all directors).

Four directors (2017: four directors) received shares in United Utilities Group PLC in respect of qualifying services. Four directors (2017: four directors) had long-term incentive plans which vested during the year. Aggregate amounts receivable relating to long-term incentive plans of £0.8 million (2017: £1.1 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.

*The 2017 figure has been restated to reflect amounts that became receivable during the year relating to long-term incentive plans rather than including amounts that could become receivable in future years.

Remuneration of key management personnel

	2018 £m	2017 £m
Salaries and short-term employee benefits	5.6	5.7
Severance	0.6	-
Post-employment benefits	-	0.1
Share-based payment charge	2.4	2.7
	8.6	8.5

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	2018 £m	2017 £m
Wages and salaries	220.7	219.9
Employee related taxes and levies	22.8	21.7
Severance	3.7	7.0
Post-employment benefits:		
Defined benefit pension expense (see note 16)	32.2	25.5
Defined contribution pension expense (see note 16)	12.1	11.2
	44.3	36.7
Charged to regulatory capital schemes	(138.0)	(129.4)
Amounts recharged to related parties at nil margin under transitional service agreements (see note A6)	-	(4.0)
Employee benefits expense	153.5	151.9

Within employee benefits expense were £6.0 million (2017: £10.1 million) of restructuring cost.

Conditional share awards in relation to 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 scheme are given in the 2018 UUG annual report and financial statements. Included within wages and salaries is an expense of £3.2 million (2017: £3.4 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	2018 number	2017 number
Average number of employees during the year	5,223	5,310

Company

The average number of employees during the year was 259 (2017: 277*). These employees were engaged in the provision of services to United Utilities Water Limited, and as such employee costs of £19.8 million (2017: £19.0 million*) in relation to these employees have been incurred directly by that company during the year.

* Re-presented due to improvements in headcount data.

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:

	2018 £m	2017 £m
Other operating costs		
Hired and contracted services	97.7	101.5
Property rates	90.5	91.6
Power	70.4	68.7
Materials	67.3	67.7
Regulatory fees	29.7	28.6
Charge for bad and doubtful receivables (see note 13)	20.8	29.9
Cost of properties disposed	9.8	8.6
Loss on disposal of property, plant and equipment	6.8	3.3
Legal and professional expenses	5.8	6.5
Operating leases payable:		
Property	3.5	3.8
Plant and equipment	0.7	0.6
Third party wholesale charges	-	3.0
Impairment of property, plant and equipment (see note 8)	-	0.2
Compensation from insurers	(3.6)	(12.3)
Amortisation of deferred grants and contributions (see note 19)	(6.4)	(6.7)
Other expenses	30.4	40.1
	423.4	435.1
Other income		
Other income	(3.8)	(4.2)
	(3.8)	(4.2)
Depreciation and amortisation expense		
Depreciation of property, plant and equipment (see note 8)	348.4	336.2
Amortisation of intangible assets (see note 9)	28.4	28.7
	376.8	364.9

As a result of two significant flooding incidents caused by storms Desmond and Eva in December 2015, there were £5.3 million (2017: £13.8 million) of expenses incurred, comprising £2.9 million (2017: £11.1 million) of operating costs, £2.4 million (2017: £2.5 million) of infrastructure renewals expenditure, and a £nil (2017: £0.2 million) impairment of property, plant and equipment. Insurance compensation of £3.6 million (2017: £12.3 million) relating to the flooding incidents has been recognised as part of a final settlement of the insurance claim. The group does not expect there to be any further costs or insurance receipts in respect of the flooding incidents.

In addition, there were £1.0 million (2017: £5.8 million) of market reform restructuring costs relating to the non-household retail market opening to competition in April 2017.

Total other operating costs are stated net of £1.4 million (2017: £14.5 million) of costs recharged to Water Plus at nil margin under transitional service agreements.

Research and development expenditure for the year ended 31 March 2018 was £1.2 million (2017: £2.3 million).

Notes to financial statements

3. Operating profit (continued)

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

	2018 £000	2017 £000
Audit services:		
Statutory audit - group and company	73	63
Statutory audit - subsidiaries	268	251
	341	314
Non-audit services:		
Regulatory audit services provided by the statutory auditor	46	53
Other non-audit services	80	201
	467	568

4. Investment income

	2018 £m	2017 £m
Interest receivable on short-term bank deposits held at amortised cost	1.5	0.9
Interest receivable on loan to joint ventures held at amortised cost (see note A6)	3.4	2.6
Net pension interest income (see note 16)	7.1	10.2
Interest receivable from ultimate parent undertaking (see note A6)	25.4	27.8
	37.4	41.5

Notes to financial statements

5. Finance expense

	2018 £m	2017 £m
Interest payable		
Interest payable on borrowings held at amortised cost[(1)]	265.9	227.0
	265.9	227.0
Fair value losses/(gains) on debt and derivative instruments[(2)]		
Fair value hedge relationships:		
Borrowings	(149.2)	70.4
Designated swaps	159.6	(81.4)
	10.4	(11.0)
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss[(3)]	(27.8)	37.5
Associated swaps[(4)]	63.7	(30.1)
	35.9	7.4
Fixed interest rate swaps[(4)]	(87.4)	0.8
Electricity swaps[(4)]	(8.0)	(9.6)
Net receipts on swaps and debt under fair value option	(20.4)	(14.4)
Other swaps[(4)(5)]	2.2	(5.0)
Realisation of fair value loss on settlement of borrowings held at amortised cost[(6)]	23.1	-
Other	(3.1)	7.5
	(93.6)	(20.7)
Net fair value gains on debt and derivative instruments[(7)]	(47.3)	(24.3)
	218.6	202.7

Notes:

(1) Includes a £137.8 million (2017: £80.7 million) non-cash inflation uplift expense repayable on maturity in relation to the group's index-linked debt.

(2) Includes foreign exchange gains of £56.5 million (2017: £119.7 million losses), 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 £24.0 million loss (2017: £11.9 million) 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) This fair value loss results from the partial close-out of £50.0 million RPI index-linked notes due April 2043. The portion of the notes closed out had a nominal value of £30.0 million (carrying value £43.0 million), and were purchased at a fair value of £64.4 million resulting in a £23.1 million fair value loss.

(7) Includes £23.5 million income (2017: £15.4 million) due to net interest on swaps and debt under fair value option.

Interest payable is stated net of £39.7 million (2017: £29.2 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 3.6 per cent (2017: 3.0 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

Notes to financial statements

6. Tax

	2018 £m	2017 £m
Current tax		
UK corporation tax	30.2	59.5
Adjustments in respect of prior years	(6.7)	(22.5)
Total current tax charge for the year	23.5	37.0
Deferred tax		
Current year	51.7	28.2
Adjustments in respect of prior years	7.1	7.0
	58.8	35.2
Change in tax rate	-	(58.2)
Total deferred tax charge/(credit) for the year	58.8	(23.0)
Total tax charge for the year	82.3	14.0

The prior year deferred tax credit of £58.2 million reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020. The adjustments in respect of prior years relate to agreement with the tax authorities of prior years' UK tax matters; the prior 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:

	2018 £m	2018 %	2017 £m	2017 %
Profit before tax	457.5		470.2	
Tax at the UK corporation tax rate	86.9	19.0	94.0	20.0
Adjustments in respect of prior years	0.4	0.1	(15.5)	(3.3)
Change in tax rate	-	-	(58.2)	(12.4)
Net income not taxable/other	(5.0)	(1.1)	(6.3)	(1.3)
Total tax charge and effective tax rate for the year	82.3	18.0	14.0	3.0

Notes to financial statements

6. Tax (continued)

Tax on items taken directly to equity

	2018	2017
Group	£m	£m
Current tax		
Relating to other pension movements	-	(9.8)
	-	(9.8)
Deferred tax (see note 17)		
On remeasurement gains/(losses) on defined benefit pension schemes	8.5	(13.8)
Relating to other pension movements	-	8.8
Change in tax rate	-	(2.5)
	8.5	(7.5)
Total tax charge/(credit) on items taken directly to equity	8.5	(17.3)

The prior year deferred tax credit of £2.5 million reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020.

	2018	2017
Company	£m	£m
Current tax		
Relating to other pension movements	-	(2.2)
	-	(2.2)
Deferred tax (see note 17)		
On remeasurement gains on defined benefit pension schemes	2.7	(1.1)
Relating to other pension movements	-	2.0
Change in tax rate	-	(0.5)
	2.7	0.4
Total tax charge/(credit) on items taken directly to equity	2.7	(1.8)

7. Dividends

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

	2018	2017
	£m	£m
Ordinary shares		
Interim dividend for the year ended 31 March 2018 at 20.04 pence per share (2017: 19.82 pence)	176.8	174.8
Interim dividend for the year ended 31 March 2018 at 10.24 pence per share (2017: 10.01 pence)	90.3	88.3
	267.1	263.1

Notes to financial statements

8. 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 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
Additions	2.4	70.7	122.2	10.1	535.9	741.3
Transfers	12.0	72.6	141.8	23.4	(249.8)	-
Disposals	(1.4)	(0.1)	(46.4)	(3.7)	-	(51.6)
At 31 March 2018	**367.2**	**5,386.3**	**7,250.8**	**526.6**	**1,228.4**	**14,759.3**
Accumulated depreciation						
At 1 April 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
Charge for the year	9.4	39.5	260.9	38.6	-	348.4
Disposals	(1.3)	-	(39.3)	(3.1)	-	(43.7)
At 31 March 2018	**119.7**	**385.4**	**3,092.3**	**371.4**	**-**	**3,968.8**
Net book value at 31 March 2017	242.6	4,897.2	4,162.5	160.9	942.3	10,405.5
Net book value at 31 March 2018	**247.5**	**5,000.9**	**4,158.5**	**155.2**	**1,228.4**	**10,790.5**

At 31 March 2018, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £430.1 million (2017: £335.2 million).

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

Company

The company had no property, plant and equipment or contractual commitments for the acquisition of property, plant and equipment at 31 March 2018 or 31 March 2017.

Notes to financial statements

9. Intangible assets

Group	Total £m
Cost	
At 1 April 2016	310.9
Additions	54.5
Disposals	(8.2)
At 31 March 2017	357.2
Additions	38.4
At 31 March 2018	395.6
Accumulated amortisation	
At 1 April 2016	148.5
Charge for the year	28.7
Disposals	(7.7)
At 31 March 2017	169.5
Charge for the year	28.4
At 31 March 2018	197.9
Net book value at 31 March 2017	187.7
Net book value at 31 March 2018	197.7

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

At 31 March 2018, the group had entered into contractual commitments for the acquisition of intangible assets amounting to £2.8 million (2017: £1.7 million).

Company

The company had no intangible assets or contractual commitments for the acquisition of intangible assets at 31 March 2018 or 31 March 2017.

10. Joint ventures

Group	Total £m
At 1 April 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
Share of profits of joint ventures	2.3
Dividends received from joint ventures	(3.3)
Currency translation differences	1.0
At 31 March 2018	75.2

Notes to financial statements

10. Joint ventures (continued)

The group’s interests in joint ventures mainly comprise its interests in Water Plus Group Limited (Water Plus) and AS Tallinna Vesi (Tallinn Water).

Water Plus is jointly owned and controlled by the group and Severn Trent PLC under a joint venture agreement. Joint management of Tallinn Water is based on a shareholders’ agreement.

Tallinn Water has disclosed a new contingent liability of EUR 26.5 million in its latest financial statements relating to possible third-party claims. If this contingent liability materialises in the future this would impact the group’s share of profits of the joint venture and the joint venture’s carrying value under the equity method of accounting.

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 2018, the Company had investments in joint ventures of £39.1 million (2017: £39.1 million).

11. Investments

Group	Total £m
At 1 April 2016	8.7
Disposals	(0.9)
Currency translation differences	1.2
At 31 March 2017	9.0
Disposals	(1.0)
Currency translation differences	(0.9)
At 31 March 2018	7.1

During the year, the group reduced its investment in Muharraq Holding Company 1 Limited through a £1.0 million (2017: £0.9 million) repayment of a shareholder loan.

At 31 March 2018, the group's investments mainly comprised its investment in Muharraq Holding Company 1 Limited. These investments are held at fair value.

Company	Shares in subsidiary undertakings £m
At 1 April 2016	4,209.6
Disposals	(18.6)
Impairment	(9.8)
At 31 March 2017	4,181.2
Impairment	(5.0)
Net book value at 31 March 2018	4,176.1

During the year ended 31 March 2018, an impairment of £5.0m was made to the investment in United Utilities (Tallinn) B.V. due to a decrease in the fair value of its investment in Tallinna Vesi following an adverse court judgement.

Notes to financial statements

11. Investments (continued)

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 B.V. 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.

12. Inventories

Group	2018 £m	2017 £m
Properties held for resale	9.0	13.5
Other inventories	7.8	8.9
	16.8	22.4

Company

The company had no inventories at 31 March 2018 or 31 March 2017**.**

13. Trade and other receivables

		Group		**Company**
	2018 £m	2017 £m	2018 £m	2017 £m
Trade receivables	116.7	124.7	0.2	0.2
Amounts owed by subsidiary undertakings	-	-	1,602.1	1,593.5
Amounts owed by ultimate parent undertaking (see note A6)	1,699.4	1,674.1	1,699.4	1,674.1
Amounts owed by other related parties (see note A6)	179.7	163.5	35.8	19.2
Other debtors and prepayments	40.8	62.0	-	-
Accrued income	64.8	66.0	-	-
	2,101.4	2,090.3	3,337.5	3,287.0

At 31 March 2018 the group had £1,831.4 million (2017: £1,777.7 million) and the company had £1,726.2 million (2017: £1,674.4 million) of trade and other receivables classified as non-current. These included £1,690.4 million (2017: £1,665.4 million) relating to amounts owed by the ultimate parent undertaking and £35.8 million (2017: £9.0 million) relating to amounts owed by other related parties.

Amounts owed by subsidiary undertakings represents the sum of all subsidiary balances where the total of intercompany 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:

Notes to financial statements

13. Trade and other receivables (continued)

Group	2018 £m	2017 £m
At the start of the year	85.4	94.4
Amounts charged to operating expenses (see note 3)	20.8	29.9
Trade receivables written off	(44.6)	(38.9)
Amounts charged to deferred income	1.6	-
Amounts charged to infrastructure renewals expenditure	0.2	-
At the end of the year	63.4	85.4

Amounts charged to deferred income relate to amounts invoiced for which revenue has not yet been recognised in the income statement.

Amounts charged to infrastructure renewals expenditure relate to amounts invoiced in relation to contributions towards the cost of infrastructure renewals incurred as a result of carrying out infrastructure diversions works.

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

At 31 March 2018 and 31 March 2017, 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:

Company	2018 £m	2017 £m
At the start of the year	89.4	89.7
Amounts charged to operating expenses	5.8	1.1
Trade receivables written off	-	(1.4)
At the end of the year	95.2	89.4

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 2018	77.5	24.4	4.2	106.1
At 31 March 2017	79.9	32.0	5.0	116.9

At 31 March 2018, the group had £10.6 million (2017: £7.8 million) of trade receivables that were not past due.

Notes to financial statements

13. Trade and other receivables (continued)

Company

At 31 March 2018 and 31 March 2017, 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 2018 and 31 March 2017.

14. Cash and cash equivalents

		Group		**Company**
	2018 £m	2017 £m	2018 £m	2017 £m
Cash at bank and in hand	1.0	1.5	0.1	0.2
Short-term bank deposits	509.0	246.3	9.5	50.0
Cash and short-term deposits	510.0	247.8	9.6	50.2
Book overdrafts (included in borrowings, see note 15)	(12.1)	(26.9)	-	-
Cash and cash equivalents in the statement of cash flows	497.9	220.9	9.6	50.2

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.

15. Borrowings

	2018	2017
Group	£m	£m
Non-current liabilities		
Bonds	4,723.4	4,851.0
Bank and other term borrowings	2,349.4	2,207.4
	7,072.8	7,058.4
Current liabilities		
Bonds	583.2	37.3
Bank and other term borrowings	243.7	261.3
Book overdrafts (see note 14)	12.1	26.9
Amounts owed to ultimate parent undertaking	62.0	61.3
	901.0	386.8
	7,973.8	7,445.2

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

Notes to financial statements

15. Borrowings (continued)

Company	2018 £m	2017 £m
Non-current liabilities		
Bonds	282.7	815.8
Current liabilities		
Bonds	432.4	-
Bank and other term borrowings	116.5	135.1
Amounts owed to subsidiary undertakings	721.5	711.4
Amounts owed to ultimate parent undertaking	62.0	61.3
	1,332.4	907.8
	1,615.1	1,723.6

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

16. 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	
	2018 £m	2017 £m	2018 £m	2017 £m
Current service cost	27.3	19.7	1.7	1.4
Curtailments/settlements	2.3	3.1	0.1	0.3
Administrative expenses	2.6	2.7	0.8	0.9
Pension expense charged to operating profit	32.2	25.5	2.6	2.6
Net pension interest income credited to investment income (see note 4)	(7.1)	(10.2)	(1.6)	(1.8)
Net pension expense charged before tax	25.1	15.3	1.0	0.8

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £29.9 million (2017: £22.4 million) for the group and £2.5 million (2017: £2.3 million) for the company, comprising current service costs and administrative expenses.

Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £42.0 million (2017: £33.6 million) for the group and £2.5 million (2017: £2.3 million) for the company comprise the defined benefit costs described above of £29.9 million (2017: £22.4 million) for the group and £2.5 million (2017: £2.3 million) for the company, and defined contribution pension costs of £12.1 million (2017: £11.2 million) for the group and £nil (2017: £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:

Notes to financial statements

16. Retirement benefit surplus (continued)

	Group		Company	
	2018	2017	2018	2017
	£m	£m	£m	£m
At the start of the year	247.5	275.2	53.0	48.3
Expense recognised in the income statement	(25.1)	(15.3)	(1.0)	(0.8)
Contributions paid	71.6	64.3	12.5	11.8
Remeasurement gains/(losses) gross of tax	50.2	(76.7)	15.6	(6.3)
At the end of the year	344.2	247.5	80.1	53.0

Included in the group contributions paid of £71.6 million (2017: £64.3 million) and company contributions paid of £12.5 million (2017: £11.8 million) were deficit repair contributions for the group of £43.0 million (2017: £43.0 million) and for the company of £10.2 million (2017: £10.2 million), and an inflation funding mechanism payment of £0.4 million made during the year (2017: £nil) for the group and £0.1 million (2017: £nil) for the company. Following the 2016 actuarial valuation, contributions in relation to current service cost increased to £26.2 million (2017: £18.9 million) for the group and £1.6 million (2017: £1.3 million) for the company.

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

	Group		Company	
	2018	2017	2018	2017
	£m	£m	£m	£m
The return on plan assets, excluding amounts included in interest	(60.0)	555.5	(13.5)	138.6
Actuarial gains/(losses) arising from changes in financial assumptions	85.1	(721.4)	21.8	(182.9)
Actuarial gains arising from changes in demographic assumptions	43.2	52.7	11.6	14.8
Actuarial (losses)/gains arising from experience	(18.1)	36.5	(4.3)	23.2
Remeasurement gains/(losses) on defined benefit pension schemes	50.2	(76.7)	15.6	(6.3)

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 £12.1 million (2017: £11.2 million) of contributions and the company made £nil (2017: £nil) of contributions to defined contribution schemes which are included in employee benefit expense (see note 2).

Notes to financial statements

17. 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 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
Charged to the income statement (see note 6)	38.5	7.9	12.4	58.8
Charged to equity (see note 6)	-	8.5	-	8.5
At 31 March 2018	1,049.9	58.5	(9.6)	1,098.8
Company				
At 1 April 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
Charged to the income statement	-	2.0	0.2	2.2
Charged to equity (see note 6)	-	2.7	-	2.7
At 31 March 2018	(0.1)	13.8	(0.2)	13.5

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

18. Provisions

Group	Severance £m	Other £m	Total £m
At 1 April 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
Charged to the income statement	3.7	1.0	4.7
Utilised in the year	(4.8)	(4.3)	(9.1)
At 31 March 2018	2.6	19.5	22.1

The group had no provisions classed as non-current at 31 March 2018 or 31 March 2017.

The severance provision as at 31 March 2018 and 31 March 2017 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 2018 or 31 March 2017.

Notes to financial statements

19. Trade and other payables

	2018 £m	2017 £m
Group		
Non-current		
Deferred grants and contributions	617.0	570.7
Other creditors	25.7	18.6
	642.7	589.3

Company

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

	Group		Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Current				
Trade payables	27.9	35.2	0.2	-
Amounts owed to ultimate parent undertaking	12.2	7.8	10.4	5.6
Amounts owed to subsidiary undertakings	-	-	72.1	80.1
Amounts owed to other related parties	1.4	12.1	0.6	-
Other tax and social security	5.3	5.1	-	-
Deferred grants and contributions	8.8	8.5	-	-
Accruals and other creditors	189.4	220.9	11.1	13.4
Deferred income	40.6	39.5	-	-
	285.6	329.1	94.4	99.1

The average credit period taken for trade purchases for the group is 23 days (2017: 23 days) and for the company is nil days (2017: nil days).

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

Deferred grants and contributions

	2018 £m	2017 £m
Group		
At the start of the year	579.2	526.4
Amounts capitalised during the year	23.7	29.0
Transfers of assets from customers	34.2	33.5
Credited to income statement – revenue	(3.3)	(3.0)
Credited to the income statement – other operating costs (see note 3)	(6.4)	(6.7)
Credited to allowance for bad and doubtful receivables	(1.6)	-
At the end of the year	625.8	579.2

20. Share capital

	2018 number	2018 £	2017 number	2017 £
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.

Notes to financial statements

21. Operating lease commitments

Group	Property 2018 £m	Plant and equipment 2018 £m	Property 2017 £m	Plant and equipment 2017 £m
Commitments under non-cancellable operating leases due				
Within one year	2.6	0.6	2.8	0.6
In the second to fifth years inclusive	9.4	0.4	10.2	0.4
After five years	279.9	-	277.9	-
	291.9	1.0	290.9	1.0

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 2018 £m	Property 2017 £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

22. Contingent liabilities

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 (2017: none) or the company (2017: none).

23. 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 2018.

24. 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	
	2018	2017	2018	2017
	£m	£m	£m	£m
Profit before tax	457.5	470.2	329.4	339.3
Adjustment for investment income (see note 4) and finance expense (see note 5)	181.2	161.2	(22.3)	(35.7)
Adjustment for profit on disposal of business	-	(22.1)	-	-
Adjustment for share of profits of joint ventures (see note 10)	(2.3)	(3.8)	-	-
Operating profit	636.4	605.5	307.1	303.6
Adjustments for:				
Depreciation of property, plant and equipment (see note 8)	348.4	336.2	-	-
Amortisation of intangible assets (see note 9)	28.4	28.7	-	-
Impairment of property, plant and equipment (see note 8)	-	0.2	-	-
Loss on disposal of property, plant and equipment (see note 3)	6.8	3.3	-	-
Loss on disposal of intangible assets	-	0.5	-	-
Amortisation of deferred grants and contributions (see note 19)	(6.4)	(6.7)	-	-
Other non-cash movements	(3.3)	(3.0)	5.0	(8.6)
Changes in working capital:				
Decrease in inventories (see note 12)	5.6	6.9	-	-
Decrease/(increase) in trade and other receivables	2.6	42.6	(40.7)	(51.6)
(Decrease)/increase in trade and other payables	(14.0)	(5.1)	39.5	91.5
(Decrease)/increase in provisions (see note 18)	(4.4)	11.4	-	-
Pension contributions paid less pension expense charged to operating profit	(39.4)	(38.8)	(9.9)	(9.2)
Cash generated from operations	960.7	981.7	301.0	325.7

The group has received property, plant and equipment of £34.2 million (2017: £33.5 million) in exchange for the provision of future goods and services (see notes 19 and A7).

A2. Net Debt

	2018	2017
Group	£m	£m
At the start of the year	6,639.4	6,315.8
Net capital expenditure	701.0	691.7
Dividends (see note 7)	267.1	263.1
Loans to joint ventures	26.5	109.0
Interest	113.6	127.6
Inflation uplift on index-linked debt (see note 5)	137.8	80.7
Tax	35.5	41.2
Other	(4.0)	1.9
Fair value movements*	(26.9)	(9.9)
Cash generated from operations (see note A1)	(960.7)	(981.7)
At the end of the year	6,929.3	6,639.4

*Fair value movements includes net fair value gains on debt and derivative instruments of £47.3 million (2017: £24.3 million), less £20.4 million (2017: £14.4 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 2018 £m	Carrying value 2018 £m	Fair value 2017 £m	Carrying value 2017 £m
Borrowings in fair value hedge relationships			**2,905.9**	**2,895.3**	**2,544.6**	**2,522.4**
5.375% 150m bond	GBP	2018	157.9	150.8	164.3	156.8
4.55% 250m bond	USD	2018	181.2	178.8	208.1	204.7
5.375% 350m bond	USD	2019	256.5	253.6	295.3	294.8
4.25% 500m bond	EUR	2020	478.8	466.4	478.9	469.7
5.75% 375m bond	GBP	2022	435.3	411.5	455.4	429.3
2.0% 300m bond	GBP	2025	299.6	301.5	-	-
2.92% 739m bond	HKD	2026	65.9	66.9	-	-
1.129% 52m bond	EUR	2027	45.0	44.5	43.5	43.6
2.37% 830m bond	HKD	2027	70.6	72.4	-	-
5.625% 300m bond	GBP	2027	388.6	393.2	408.7	412.1
5.02% JPY 10bn dual currency loan	JPY/USD	2029	86.9	95.0	97.7	105.8
2.058% 30m bond	EUR	2030	27.0	26.7	27.0	26.3
1.641% 30m bond	EUR	2031	25.7	25.0	25.7	24.6
2.9% 600m bond	HKD	2031	52.4	48.3	61.1	56.4
1.707% 28m bond	EUR	2032	23.9	24.7	-	-
1.653% 26m bond	EUR	2032	21.9	22.4	-	-
1.70% 30m bond	EUR	2033	25.4	26.4	-	-
5.0% 200m bond	GBP	2035	263.3	287.2	278.9	298.3
Borrowings designated at fair value through profit or loss			**347.7**	**347.7**	**375.5**	**375.5**
6.875% 400m bond	USD	2028	347.7	347.7	375.5	375.5
Borrowings measured at amortised cost			**5,859.9**	**4,730.8**	**5,743.5**	**4,547.3**
1.30%+LIBOR 5bn bond	JPY	2017	-	-	36.3	37.3
Short-term bank borrowings - fixed	GBP	2018	161.5	161.5	202.0	202.0
1.61%+RPI 50m EIB IL loan	GBP	2020	67.6	63.7	67.8	61.2
1.73%+RPI 50m EIB IL loan	GBP	2020	67.8	63.6	68.0	61.2
1.84%+RPI 50m EIB IL loan	GBP	2020	67.9	63.5	68.2	61.1
1.90%+RPI 50m EIB IL loan	GBP	2020	67.9	63.4	68.2	61.0
1.93%+RPI 50m EIB IL loan	GBP	2020	67.9	63.4	68.2	60.9
1.88%+RPI 50m EIB IL loan	GBP	2020	67.7	63.3	68.1	60.9
2.10%+RPI 50m EIB IL loan	GBP	2020	68.0	63.2	68.5	60.8
2.46%+RPI 50m EIB IL loan	GBP	2020	68.6	63.2	69.3	60.8
0.80%+LIBOR 100m loan	GBP	2022	102.6	100.0	102.6	100.0
0.47%+RPI 100m IL loan	GBP	2023	117.9	112.2	116.5	107.9
0.49%+RPI 100m IL loan	GBP	2025	116.2	107.9	115.6	103.8
0.013%+RPI 25m IL bond	GBP	2025	28.1	26.9	28.1	25.9
0.1275%+RPI 100m IL loan	GBP	2026	111.7	106.5	112.3	102.4
0.01%+RPI 20m IL bond	GBP	2028	22.1	22.9	22.0	22.3
1.23%+RPI 50m EIB (amortising) IL loan	GBP	2029	51.2	47.4	55.1	49.7
1.29%+RPI 50m EIB (amortising) IL loan	GBP	2029	53.4	49.2	57.4	51.5
1.12%+RPI 50m EIB (amortising) IL loan	GBP	2029	52.6	48.8	56.5	51.0
1.10%+RPI 50m EIB (amortising) IL loan	GBP	2029	52.5	48.8	56.3	51.0
0.75%+RPI 50m EIB (amortising) IL loan	GBP	2029	52.9	49.8	56.5	51.9
0.76%+RPI 50m EIB (amortising) IL loan	GBP	2030	52.8	49.6	56.4	51.7

Notes to the financial statements – appendices

A3. Borrowings (continued)

	Currency	Year of final repayment	Fair value 2018 £m	Carrying value 2018 £m	Fair value 2017 £m	Carrying value 2017 £m
Borrowings measured at amortised cost (continued)						
1.15%+RPI 50m EIB (amortising) IL loan	GBP	2030	53.7	49.4	57.5	51.5
1.11%+RPI 50m EIB (amortising) IL loan	GBP	2030	53.7	49.6	57.6	51.7
0.178%+RPI 35m IL bond	GBP	2030	40.4	37.6	40.2	36.2
0.245%+CPI 20m IL bond	GBP	2031	20.3	20.6	20.2	20.0
0.01%+RPI 38m IL bond	GBP	2031	42.4	42.6	42.2	41.3
3.375%+RPI 50m IL bond	GBP	2032	122.4	76.9	124.1	74.2
0.709%+LIBOR 100m EIB (amortising) loan	GBP	2032	86.6	87.5	94.9	93.8
0.691%+LIBOR 150m EIB (amortising) loan	GBP	2032	134.4	135.9	146.4	145.3
0.573%+LIBOR 100m EIB (amortising) loan	GBP	2033	92.0	93.8	100.2	100.0
0.511%+LIBOR 150m EIB (amortising) loan	GBP	2033	141.6	145.3	149.6	150.0
0.01%+RPI 100m EIB (amortising) IL loan	GBP	2033	109.6	106.4	107.9	102.3
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	82.2	79.7	80.9	76.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	81.8	79.3	80.7	76.2
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	81.8	79.3	80.7	76.2
1.9799%+RPI 100m IL bond	GBP	2035	208.3	143.9	212.4	138.9
0.873%+LIBOR 100m EIB (amortising) loan	GBP	2035	99.6	100.0	-	-
0.840%+LIBOR 75m (amortising) loan	GBP	2035	75.2	75.0	-	-
0.01%+RPI 26.5m IL bond	GBP	2036	30.1	31.8	30.3	31.0
0.379%+CPI 20m IL bond	GBP	2036	20.7	20.6	20.9	20.0
0.01%+RPI 29m IL bond	GBP	2036	32.9	32.5	32.2	31.5
0.093%+CPI 60m IL bond	GBP	2037	58.8	61.4	59.0	59.6
1.66%+RPI 35m IL bond	GBP	2037	61.9	46.5	62.7	44.7
2.40%+RPI 70m IL bond	GBP	2039	135.9	90.7	132.2	87.2
1.7829%+RPI 100m IL bond	GBP	2040	219.0	142.4	207.5	137.5
1.3258%+RPI 50m IL bond	GBP	2041	100.7	71.1	95.7	68.6
1.5802%+RPI 100m IL bond	GBP	2042	214.7	142.0	202.6	137.0
1.5366%+RPI 20m IL bond	GBP	2043	43.2	28.3	41.0	27.4
1.5366%+RPI 30m IL bond	GBP	2043	-	-	61.4	41.0
1.397%+RPI 50m IL bond	GBP	2046	109.1	71.0	102.9	68.5
0.359%+CPI 32m IL bond	GBP	2048	32.0	32.4	-	-
1.7937%+RPI 50m IL bond	GBP	2049	122.9	70.7	118.0	68.2
Commission for New Towns (amortising) loan - fixed	GBP	2053	56.2	27.9	56.1	28.4
1.847%+RPI 100m IL bond	GBP	2056	232.2	140.3	224.1	135.0
1.815%+RPI 100m IL bond	GBP	2056	231.7	139.8	221.5	134.4
1.662%+RPI 100m IL bond	GBP	2056	222.0	139.5	218.2	134.2
1.5865%+RPI 50m IL bond	GBP	2056	109.2	69.7	105.8	67.0
1.591%+RPI 25m IL bond	GBP	2056	54.7	34.8	52.5	33.4
1.556%+RPI 50m IL bond	GBP	2056	108.6	69.3	105.3	66.7
1.435%+RPI 50m IL bond	GBP	2056	105.9	69.1	102.5	66.5
1.3805%+RPI 35m IL bond	GBP	2056	73.5	48.4	71.0	46.5
1.585%+RPI 100m IL bond	GBP	2057	218.9	134.2	208.6	129.1
0.387%+CPI 33m IL bond	GBP	2057	33.2	33.0		
1.702%+RPI 50m IL bond	GBP	2057	112.9	67.7	107.9	65.1
Amounts owed to ultimate parent undertaking	GBP	2018	62.0	62.0	61.3	61.3
Book overdrafts (see note 14)	GBP	2018	12.1	12.1	26.9	26.9
			9,113.5	**7.973.8**	**8,663.6**	**7,445.2**

Notes to the financial statements – appendices

IL Index-linked debt – this debt is adjusted for movements in the Consumer or Retail Prices Indices with reference to a base CPI 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 and assets.

During the year, there has been a partial close-out of the £50.0 million RPI index-linked notes due April 2043. The nominal value of the portion of the notes closed-out was £30.0 million. In order to provide a prior year comparison on a like-for-like basis, the carrying and fair values of the RPI index-linked notes as at 31 March 2017 have been split to reflect this partial close-out.

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 2018 £m	Carrying value 2018 £m	Fair value 2017 £m	Carrying value 2017 £m
Borrowings in fair value hedge relationships			**437.7**	**432.4**	**503.4**	**499.5**
4.55% 250m bond	USD	2018	181.2	178.8	208.1	204.7
5.375% 350m bond	USD	2019	256.5	253.6	295.3	294.8
Borrowings measured at amortised cost			**1,247.7**	**1,182.7**	**1,283.3**	**1,224.1**
Short-term bank borrowings – fixed	GBP	2018	116.5	116.5	135.1	135.1
Amounts owed to subsidiary undertakings	GBP	2018	721.5	721.5	711.4	711.4
Amounts owed to ultimate parent undertaking	GBP	2018	62.0	62.0	61.3	61.3
6.875% 400m bond	USD	2028	347.7	282.7	375.5	316.3
			1,685.4	**1,615.1**	**1,786.7**	**1,723.6**

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

Liquidity risk

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

At 31 March 2018, the group had £1,205.0 million (2017: £1,147.8 million) of available liquidity, which comprised £510.0 million (2017: £247.8 million) of cash and short-term deposits, £695.0 million (2017: £725.0 million) of undrawn committed borrowing facilities, and £nil (2017: £175.0 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**
	2018 £m	2017 £m	2018 £m	2017 £m
Expiring within one year	100.0	150.0	20.0	20.0
Expiring after one year but in less than two years	150.0	100.0	30.0	20.0
Expiring after more than two years	500.0	500.0	185.0	185.0
Total borrowing facilities	750.0	750.0	235.0	225.0
Facilities drawn[1]	(55.0)	(25.0)	(55.0)	(25.0)
Undrawn borrowing facilities	695.0	725.0	180.0	200.0

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 2018								
Bonds	10,343.8	-	733.9	585.7	116.7	492.5	96.7	8,318.3
Bank and other term borrowings	3,118.8	-	288.9	125.2	682.5	124.5	355.3	1,542.4
Amounts owed to ultimate parent undertaking	62.0	-	62.0	-	-	-	-	-
Adjustment to carrying value[2]	(5,550.8)	(5,550.8)	-	-	-	-	-	-
Borrowings	7,973.8	(5,550.8)	1,084.8	710.9	799.2	617.0	452.0	9,860.7
Derivatives:								
Payable	1,382.5	-	404.4	475.6	28.6	22.4	19.7	431.8
Receivable	(1,885.7)	-	(750.0)	(546.9)	(28.7)	(28.7)	(51.6)	(479.8)
Adjustment to carrying value[2]	(31.3)	(31.3)	-	-	-	-	-	-
Derivatives – net assets	(534.5)	(31.3)	(345.6)	(71.3)	(0.1)	(6.3)	(31.9)	(48.0)

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)

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 2018								
Bonds	883.3	-	461.1	19.1	18.8	18.6	18.4	347.3
Bank and other term borrowings	116.7	-	116.7	-	-	-	-	-
Amounts owed to ultimate parent undertaking	62.0	-	62.0	-	-	-	-	-
Amounts owed to subsidiary undertakings	721.5	-	721.5	-	-	-	-	-
Adjustment to carrying value(2)	(168.4)	(168.4)	-	-	-	-	-	-
Borrowings	1,615.1	(168.4)	1,361.3	19.1	18.8	18.6	18.4	347.3
Derivatives:								
Payable	359.8	-	359.8	-	-	-	-	-
Receivable	(480.3)	-	(480.3)	-	-	-	-	-
Adjustment to carrying value(2)	1.8	1.8	-	-	-	-	-	-
Derivatives – net assets	(118.7)	1.8	(120.5)	-	-	-	-	-

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)	-	-	-	-

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). 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 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 2018, Water Plus was the group's single largest debtor, with amounts outstanding in relation to wholesale services of £42.2 million (2017: £40.8 million). During the year, sales to Water Plus in relation to wholesale services were £495.4 million (2017: £402.7 million). 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 13). 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 credit 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. Credit limits are refreshed annually and reviewed in the event of any credit rating action. Additionally, 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 2018 and 31 March 2017, 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		Re-presented Company
	2018	2017	2018	2017
	£m	£m	£m	£m
Cash and short-term deposits (see note 14)	510.0	247.8	9.6	50.2
Trade and other receivables (see note 13)	2,101.4	2,090.3	3,337.5	3,287.0
Investments (see note 11)	7.1	9.0	-	-
Derivative financial instruments	635.5	807.7	118.7	187.3
	3,254.0	3,154.8	3,465.8	3,524.5

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 £1,699.4 million (2017: £1,674.1 million), and £137.2 million (2017: £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 2018 the group held £106.7 million (2017: £176.9 million) and the company held £61.5 million (2017: £110.1 million) as collateral in relation to derivative financial instruments (included within short-term bank borrowings - fixed 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. Currently the group's regulatory assets are linked to RPI inflation; however, following Ofwat's decision to transition to the use of CPIH for inflation indexation for the 2020–25 regulatory period, from 2020 the group's RCV will be 50 per cent linked to RPI inflation and 50 per cent linked to CPIH inflation, with any new additions being added to the CPIH portion of the RCV.

In addition, the group's defined benefits pension schemes have continued to hedge inflation exposure, partly through a market hedge using RPI swaps and index-linked gilts, and partly through an inflation funding mechanism (see note A5), whereby company contributions are flexed for movements in RPI inflation and smoothed over a rolling five-year period. It is anticipated that the schemes will progressively increase their market hedges of inflation, with a corresponding reduction and/or removal of the inflation funding mechanism, as part of a long-term de-risking strategy.

In light of these changes, the group has reviewed its inflation hedging policy and has adopted a revised policy with the aim of maintaining around half of the group's net debt in index-linked form (where it is economic to do so), by issuing index-linked debt and/or swapping a portion of nominal debt. This is expected to remain mostly in RPI-linked form until CPI and/or CPIH debt and swaps become available in sufficient size at an economic cost.

The group believes this is an appropriate inflation hedging policy taking into account a balanced assessment of the following factors: economic hedge of United Utilities Water Limited's (UUW) RCV and revenues; cash flow timing mismatch between allowed cost of debt and the group's incurred cost of debt; the inflation risk premium that is generally incorporated into nominal debt costs; income statement volatility; hedging costs; debt maturity profile mismatch risk; and index-linked hedging positioning relative to the water sector.

As a result of the evaluation of the above factors, the group will continue to identify opportunities to maintain around 50 per cent of the group's net debt being hedged for inflation, which can be evidenced by the issuing of £65.0 million (2017: £100.0 million) of CPI index-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 £3,729.8 million at 31 March 2018 (2017: £3,602.3 million).

Notes to the financial statements – appendices

A4. Financial risk management (continued)

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.

	2018	2017
Group	£m	£m
Increase/(decrease) in profit before tax and equity		
1 per cent increase in RPI/CPI	(37.7)	(36.4)
1 per cent decrease in RPI/CPI	37.7	36.4

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 2018 or 31 March 2017.

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 currently 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 (see inflation risk section for changes being introduced by Ofwat to inflation indexation from 2020).

In the next regulatory period, Ofwat intends to continue using materially the same methodology in setting a fixed real cost of debt in relation to embedded debt (currently assumed to be 70 per cent of net debt), but will introduce a debt indexation mechanism in relation to new debt (currently assumed to be 30 per cent of net debt). The group has therefore reviewed its interest rate hedging policy, retaining most elements of the existing policy as Ofwat's embedded debt methodology is materially unchanged.

Sterling index-linked debt is left unswapped at inception, in accordance with our inflation hedging policy goal to maintain around half of the group's net debt in index-linked form. Conventional nominal debt is hedged as set out below.

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, mirroring Ofwat's expected split of 70 per cent embedded and 30 per cent new debt. However, the group will no longer substantively fix the residual floating underlying interest rates on projected nominal net debt at the start of each regulatory period, leaving this element floating until it is fixed via the above 10-year reducing balance basis, which should more closely mirror Ofwat's new debt indexation mechanism.

This interest rate hedging policy dovetails with our revised inflation hedging policy should we need to swap a portion of nominal debt to real rate form to maintain our desired mix of nominal and index-linked debt. The group seeks to manage its risk by maintaining its interest rate exposure within a UUG board approved range. Interest rate risk is reported to the treasury committee through the operational compliance report.

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Interest rate risk (continued)

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	
	2018	2017	2018	2017
	£m	£m	£m	£m
Increase/(decrease) in profit before tax and equity				
1 per cent increase in interest rate	127.5	155.1	(12.1)	(11.8)
1 per cent decrease in interest rate	(137.7)	(153.0)	12.1	12.2

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

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

Repricing analysis

The following tables categorise the group'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 2018							
Borrowings in fair value hedge relationships							
Fixed rate instruments	2,895.3	583.2	466.4	-	411.5	-	1,434.2
Effect of swaps	-	2,312.1	(466.4)	-	(411.5)	-	(1,434.2)
	2,895.3	2,895.3	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	347.7	-	-	-	-	-	347.7
Effect of swaps	-	347.7	-	-	-	-	(347.7)
	347.7	347.7	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	189.4	162.0	0.6	0.6	0.7	0.8	24.7
Floating rate instruments	749.6	749.6	-	-	-	-	-
Index-linked instruments	3,729.8	3,729.8	-	-	-	-	-
	4,668.8	4,641.4	0.6	0.6	0.7	0.8	24.7
Effect of fixed interest rate swaps	-	(3,006.3)	925.4	252.1	50.0	164.5	1,614.3
Total external borrowings	7,911.8	4,878.1	926.0	252.7	50.7	165.3	1,639.0
Amounts owed to ultimate parent undertaking	62.0	62.0	-	-	-	-	-
Total borrowings	7,973.8	4,940.1	926.0	252.7	50.7	165.3	1,639.0
Cash and short-term deposits	(510.0)	(510.0)	-	-	-	-	-
Net borrowings	7,463.8	4,430.1	926.0	252.7	50.7	165.3	1,639.0

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Repricing analysis (continued)

Group	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 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

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 2018							
Borrowings in fair value hedge relationships							
Fixed rate instruments	432.4	432.4	-	-	-	-	-
Effect of swaps	-	-	-	-	-	-	-
	432.4	432.4	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	399.2	116.5	-	-	-	-	282.7
	399.2	116.5	-	-	-	-	282.7
Total external borrowings	831.6	548.9	-	-	-	-	282.7
Amounts owed to subsidiary undertakings	721.5	721.5	-	-	-	-	-
Amounts owed to ultimate parent undertaking	62.0	62.0	-	-	-	-	-
Total borrowings	1,615.1	1,332.4	-	-	-	-	282.7
Cash and short-term deposits	(9.6)	(9.6)	-	-	-	-	-
Net borrowings	1,605.5	1,322.8	-	-	-	-	282.7

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 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

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	2018 £m	2017 £m
Increase/(decrease) in profit before tax and equity		
20 per cent increase in electricity commodity prices	9.4	9.8
20 per cent decrease in electricity commodity prices	(9.4)	(9.8)

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 UUG 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 2018, group consolidated gearing was 61 per cent (2017: 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, 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 targeted minimum 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 **2018**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets				
Investments	-	7.1	-	7.1
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	455.7	-	455.7
Derivative financial assets – held for trading(1)	-	179.8	-	179.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities – fair value hedge	-	(24.2)	-	(24.2)
Derivative financial liabilities – held for trading(1)	-	(76.8)	-	(76.8)
Financial liabilities designated as fair value through profit or loss	-	(347.7)	-	(347.7)
Financial instruments for which fair value has been disclosed				
Financial liabilities in fair value hedge relationships	(2,192.4)	(713.5)	-	(2,905.9)
Other financial liabilities at amortised cost	(2,425.6)	(3,372.8)	-	(5,798.4)
	(4,618.0)	**(3,892.4)**	**-**	**(8,510.4)**

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

Group	Level 1	Level 2	Level 3	Total
2017	£m	£m	£m	£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)

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 £151.8 million (2017: £215.7 million).

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

Company	Level 1	Level 2	Level 3	Total
2018	£m	£m	£m	£m
Financial assets at fair value through profit or loss				
Derivative financial assets – fair value hedge	-	118.4	-	118.4
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	(437.7)	-	-	(437.7)
Other financial liabilities at amortised cost	-	(1,247.7)	-	(1,247.7)
	(437.7)	**(1,129.0)**	**-**	**(1,566.7)**

Notes to the financial statements – appendices

A4. Financial risk management (continued)

Fair values (continued)

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:

(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 (2017: £0.3 million).

The group and company have calculated fair values using quoted prices where an active market exists, which has resulted in £4,618.0 million (2017: £2,704.0 million) for the group and £437.7 million (2017: £503.4 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 £1,914.0 million reduction (2017: £755.4 million reduction) in 'level 1' fair value measurements is largely due to an increase in the number of observable quoted bond prices in active markets at 31 March 2018.

During the year, the fair value of financial liabilities designated at fair value through profit or loss resulted in a £27.8 million gain (2017: £37.5 million loss). Included within this was an £24.0 million loss (2017: £11.9 million loss) attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £38.2 million profit (2017: £62.2 million). The carrying amount is £145.6 million (2017: £173.4 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.

During the year ending 31 March 2019, the majority of active members in the defined benefit sections of the UUPS will transition to a hybrid section incorporating both defined benefit and defined contribution elements. The changes have had no impact on the financial statements for the year ended 31 March 2018 as they will only take effect for pensionable service from 1 April 2018. Benefits relating to pensionable service before this date are unaffected by the changes. This transition is a consequence of an increase in future service costs and is intended to reduce the overall costs and risk to the group whilst balancing the interests of employees by maintaining an element of defined benefit pension provision.

The group also operates a series of historic 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
	2018	2017	2018	2017
	£m	£m	£m	£m
Total value of current employees benefits	913.8	917.5	66.0	63.9
Deferred members benefits	748.6	798.9	319.4	340.8
Pensioner members benefits	1,836.3	1,899.1	513.0	528.6
Total defined benefit obligation	3,498.7	3,615.5	898.4	933.3

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 2016 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

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Funding requirements (continued)

of companies are comparable only 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 2018 and 31 March 2017 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.

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 2021 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.

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 corporate bonds and gilts, supplemented by swap and gilt long-term hedges of interest and inflation rates, which perform in line with the liabilities so as to hedge against changes in interest and inflation rates. Further details of the derivatives used in reducing investment risk are disclosed in the 'Further reporting analysis' section of this appendix.

Under the Inflation Funding Mechanism (IFM), the schedule of deficit contributions are calculated for a notional amount of liabilities (UUPS: £1,572.0 million; ESPS £192.0 million) based on a fixed RPI inflation assumption of 3.0 per cent, being 1.0 per cent above Bank of England CPI target inflation. Each year the out-turn RPI inflation rate is compared to the fixed assumption and applied to the notional amount of liabilities to determine the IFM amount. This IFM amount, which may be positive or negative, represents a true-up for RPI inflation for the year in question. A cumulative total is maintained, and where this represents a payment due to the pension scheme, 20 per cent of the outstanding balance is contributed as an additional deficit contribution. This approach seeks to smooth the impact of RPI inflation, which is expected to vary around the fixed assumption, and recognises that payments can only flow into the pension scheme. The IFM does not have an accounting impact except to the extent that resulting payments give rise to a cash flow from the group and an increase in the level of scheme assets, as for any other deficit contribution.

The group expects to make contributions of £52.3 million in the year ending 31 March 2019, comprising £38.9 million to the UUPS and £4.1 million to the ESPS in respect of deficit repair contributions, £6.6 million and £0.9 million in respect of current service contributions to UUPS and ESPS respectively, and £0.6 million in respect of expenses to the ESPS; contributions of £1.1 million and £0.1 million are expected to be made under the IFM for UUPS and ESPS respectively.

The schemes' funding plans are reviewed every three years, and the next funding valuation for UUPS and 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 and part of the inflation exposure has been hedged through external market swaps and gilts, the value of which is included in the schemes' assets. The remaining inflation exposure has been hedged through the IFM, with RPI in excess of 3.0 per cent per annum being funded through an additional schedule of deficit contributions.

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 when hedged through the IFM, 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

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

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

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.

In contrast, the schemes' specific funding bases, which form the basis for regular (non-IFM) deficit repair contributions, are 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.

Pension benefits under the defined benefit element of the new UUPS hybrid section that will be effective for pensionable service from 1 April 2018 will be linked to CPI rather than RPI.

In the year ended 31 March 2018, the discount rate increased by 0.05 per cent (2017: 0.85 per cent), which includes a 0.05 per cent decrease in credit spreads and a 0.1 per cent increase in swap yields over the year. The IAS 19 remeasurement gain of £50.2 million (2017: £76.7 million) reported in note 16 has largely resulted from the impact of the decrease in credit spreads during the year, partially offset by the reduction in giltswap spreads, the favourable impact of changes in mortality during the year and growth asset gains.

Reporting and assumptions

The results of the latest funding valuations at 31 March 2016 have been adjusted for IAS 19 in order to assess the position at 31 March 2018, 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 valuations as at 31 March 2016 for both UUPS and ESPS.

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:

	2018	2017
Group and Company	% p.a.	% p.a.
Discount rate	2.60	2.55
Pensionable salary growth and pension increases	3.35	3.40
Price inflation - RPI	3.35	3.40
Price inflation - CPI	1.95	-

Demographic assumptions

At both 31 March 2018 and 31 March 2017, mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S2PA year of birth tables, with scaling factor of 108 per cent for males and 102 per cent for females, reflecting actual mortality experience. At 31 March 2018, mortality in retirement is based on CMI 2016 (2017: CMI 2015) long-term improvement factors, with a long-term annual rate of improvement of 1.75 per cent (2017: 1.75 per cent). The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

	2018	2017
Group and Company	years	years
Retired member - male	27.0	27.0
Non-retired member - male	28.7	29.0
Retired member - female	29.4	29.8
Non-retired member - female	31.1	31.9

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 £72.7 million (2017: £74.8 million) decrease/increase in the schemes' liabilities for the group, and a £17.7 million (2017: £19.3 million) decrease/increase in the schemes' liabilities for the company, at 31 March 2018, 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 £68.1 million (2017: £70.0 million) increase/decrease in the schemes' liabilities for the group, and an £16.6 million (2017: £18.1 million) increase/decrease in the schemes' liabilities for the company, at 31 March 2018, 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 2018, 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 £128.6 million (2017: £135.3 million) increase/decrease in the schemes' liabilities for the group, and a £33.0 million (2017: £34.9 million) increase/decrease in schemes' liabilities for the company, at 31 March 2018. 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 %	2018 £m	Schemes' assets %	2017 £m
Equities	9.5	363.9	9.1	350.4
Other non-equity growth assets	5.7	219.1	4.8	185.6
Gilts	47.2	1,813.3	44.8	1,729.3
Bonds	40.6	1,561.7	39.8	1,537.3
Other	(3.0)	(115.1)	1.5	60.4
Total fair value of schemes' assets	100.0	3,842.9	100.0	3,863.0
Present value of defined benefit obligations		(3,498.7)		(3,615.5)
Net retirement benefit surplus		344.2		247.5

Company	Schemes' assets %	2018 £m	Schemes' assets %	2017 £m
Equities	6.4	62.6	6.1	60.3
Other non-equity growth assets	6.8	66.7	4.8	47.5
Gilts	44.2	433.0	30.2	297.4
Bonds	43.6	426.0	42.0	414.2
Other	(1.0)	(9.8)	16.9	166.9
Total fair value of schemes' assets	100.00	978.5	100.0	986.3
Present value of defined benefit obligations		(898.4)		(933.3)
Net retirement benefit surplus		80.1		53.0

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.

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 2018	Underlying assets	Fair value of Derivatives	Combined	Underlying assets	Fair value of Derivatives	Combined
	£m	£m	£m	£m	£m	£m
Equities						
Other non-equity growth	357.3	6.6	363.9	61.5	1.1	62.6
assets	219.1	-	219.1	66.7	-	66.7
Gilts	1,813.3	-	1,813.3	433.0	-	433.0
Bonds	1,561.1	0.6	1,561.7	423.6	2.4	426.0
Other	170.1	(285.2)	(115.1)	38.8	(48.6)	(9.8)
Total fair value of schemes' assets	**4,120.9**	**(278.0)**	**3,842.9**	**1,023.6**	**(45.1)**	**978.5**

			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

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 £4.7 million (2017: £18.2 million) for the group and £0.8 million (2017: £3.1 million) for the company and currency forwards with a value of £1.9 million (2017: £11.6 million) for the group and £0.3 million (2017: £2.0 million) for the company;

- Derivatives are used within both the UUPS and ESPS bond portfolio to hedge non-sterling exposure back to sterling:
  - the UUPS value comprises credit default swaps with a value of £nil million (2017: £(10.3) million) for the group and £nil (2017: £(1.8) million) for the company, interest rate swaps with a value of £(3.9) million (2017: £nil) for the group and £(0.7) million (2017: £nil) for the company and currency forwards with a value of £1.1 (2017: £nil) for the group and £0.2 million (2017: £nil) for the company; and
  - the ESPS total value of £3.4 million (2017: £nil) for the group and £2.9 million (2017: £nil) for the company relates to interest rate swaps;

Notes to the financial statements – appendices

A5. Retirement benefits (continued)

Further reporting analysis (continued)

- Derivatives are used within both the UUPS and ESPS 'other' portfolios to manage liability risks. Both schemes use a range of derivatives to target a high level of interest rate and inflation hedging, comprising £(285.9) million (2017: £(227.8) million) for the group and £(49.2) million (2017: £(39.2) million) for the company in the UUPS and £0.7 million (2017: £37.7 million) for the group and £0.6 million (2017: 31.7 million) for the company in the ESPS. These are further broken down as follows:

  - the UUPS net value of £(285.9) million (2017: £(227.8) million) for the group and £(49.2) million (2017: £(39.2) million) for the company comprise asset swaps with a value of £(27.3) million (2017: £(132.9) million) for the group and £(4.7) million (2017: £(22.9) million) for the company, interest rate swaps with a value of £252.1 million (2017: £522.0 million) for the group and £43.4 million (2017: £89.8 million) for the company, gilt repurchase agreements with a value of £(517.2) million (2017: £(655.8) million) for the group and £(89.0) million (2017: £(112.8) million) for the company and RPI inflation swaps with a value of £6.5 million (2017: £38.9 million) for the group and £1.1 million (2017: £6.7 million) for the company; and

  - the ESPS value of £0.7 million for the group and £0.6 million for the company represents gilt repurchase agreements with a value of £2.3 million for the group and £1.9 million for the company and RPI inflation swaps with a value of £(1.6) million for the group and £(1.3) million for the company. The value at 31 March 2017 of £37.7 million for the group and £31.7 million for the company represented the total value of pooled funds which made use of derivatives (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 £567.4 million (2017: £1,179.5 million) for the group and £126.5 million (2017: £487.7 million) for the company.

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

		Group		**Company**
	2018	2017	2018	2017
	£m	£m	£m	£m
At the start of the year	3,863.0	3,245.6	986.3	835.0
Interest income on schemes' assets	97.7	109.4	25.0	28.1
The return on plan assets, excluding amounts included in interest	(60.0)	555.5	(13.5)	138.6
Member contributions	4.9	5.2	0.3	0.3
Benefits paid	(131.7)	(114.3)	(31.3)	(26.6)
Administrative expenses	(2.6)	(2.7)	(0.8)	(0.9)
Company contributions	71.6	64.3	12.5	11.8
At the end of the year	3,842.9	3,863.0	978.5	986.3

The actual return on the schemes' assets was a gain of 37.7 million (2017: £664.9 million) for the group and a gain of £11.5 million (2017: £166.7 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
	2018	2017	2018	2017
	£m	£m	£m	£m
At the start of the year	(3,615.5)	(2,970.4)	(933.3)	(786.7)
Interest cost on schemes' obligations	(90.6)	(99.2)	(23.4)	(26.3)
Actuarial gains/(losses) arising from changes in financial assumptions	85.1	(721.4)	21.8	(182.9)
Actuarial gains arising from changes in demographic assumptions	43.2	52.7	11.6	14.8
Actuarial (losses)/gains arising from experience	(18.1)	36.5	(4.3)	23.2
Curtailments/settlements	(2.3)	(3.1)	(0.1)	(0.3)
Member contributions	(4.9)	(5.2)	(0.3)	(0.3)
Benefits paid	131.7	114.3	31.3	26.6
Current service cost	(27.3)	(19.7)	(1.7)	(1.4)
At the end of the year	(3,498.7)	(3,615.5)	(898.4)	(933.3)

The equalisation of Guaranteed Minimum Pensions (GMP), for which the UK Government intends to implement legislation, is expected to have a widespread impact on defined benefit schemes operating in the UK. Such legislation could result in an increase in GMP for certain individuals, which would increase the defined benefit obligation of the schemes. At this stage, until the Government has further developed its proposals in light of ongoing legal review, 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:

	2018	2017
	£m	£m
Sales of services	496.3	404.3
Purchase of goods and services	0.7	0.7
Costs recharged at nil margin under transitional service agreements	1.4	18.5
Interest income and fees recognised on loans to joint ventures	3.4	2.6
Amounts owed by related parties	179.7	163.5
Amounts owed to related parties	1.4	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 2018, amounts owed by joint ventures, as recorded within trade and other receivables in the statement of financial position, were £179.7 million (2017: £163.5 million), comprising £42.5 million (2017: £41.5 million) of trade balances, which are unsecured and will be settled in accordance with normal credit terms, and £137.2 million (2017: £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;

- £9.3 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 £9.3 million receivable held at fair value, and £3.2 million recorded as an equity contribution to Water Plus recognised within interests in joint ventures; and

- £26.5 million outstanding on a £32.5 million revolving credit facility provided by United Utilities PLC, with a maturity date of 30 September 2019,bearing a floating interest rate of LIBOR plus a credit margin.

A further £1.4 million of non-current receivables (2017: £3.3 million) was owed by other related parties at 31 March 2018.

£nil expense or allowance has been recognised for bad and doubtful receivables in respect of amounts owed by related parties (2017: £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.

At 31 March 2018, amounts owed to joint ventures were £1.4 million (2017: £12.1 million). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms (2017: same).

Notes to the financial statements – appendices

A6. Related party transactions (continued)

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

	Interest receivable	
	2018	2017
	£m	£m
Ultimate parent undertaking	25.4	27.8

	*Re-presented Intercompany group tax relief payable	
	2018	2017
	£m	£m
Ultimate parent undertaking	10.4	5.6

			*Re-presented	
	Amounts owed by related parties		Amounts owed to related parties	
	2018	2017	2018	2017
	£m	£m	£m	£m
Ultimate parent undertaking	1,699.4	1,674.1	74.2	69.1

*Prior year comparatives have been re-presented to include intercompany group tax relief payable of £5.6 million. Intercompany group tax relief payable at 31 March 2018 was £10.4 million.

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 £319.9 million (2017: £324.8 million), including dividends totalling £316.7 million (2017: £248.1 million) received from United Utilities North West, a dividend of £3.2 million (2017: £5.3 million) received from United Utilities (Tallinn) BV and a dividend of £nil (2017: £71.4 million) paid by United Utilities BV prior to the company's disposal of that subsidiary.

Total interest receivable during the year from subsidiary undertakings was £25.8 million (2017: £29.1 million), and total fair value losses during the year relating to balances with subsidiary undertakings were £41.8 million (2017: £26.8 million gains). In addition, total net interest receivable during the year from the ultimate parent company was £25.4 million (2017: £27.8 million). Amounts outstanding at 31 March 2018 between the parent company, subsidiary undertakings and ultimate parent undertaking are provided in notes 13, 19 and A3.

An allowance for doubtful receivables of £95.2 million (2017: £89.4 million) has been made for amounts owed by subsidiary undertakings (see note 13). In the year ended 31 March 2018, a charge of £5.8 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2017: £1.1 million charge).

As at 31 March 2018, total guarantees given by the company to its related parties were £2,181.4 million (2017: £2,018.6 million). Included within these guarantees were the following amounts:

- £1,882.1 million (2017: £1,718.6 million) relating to United Utilities Water Limited's loans from the European Investment Bank;
- £96.5 million (2017: £96.5 million) relating to intra-group loans made between United Utilities Utility Solutions Holdings Limited and United Utilities Water Operations Holdings Limited;

Notes to the financial statements – appendices

- £100.0 million (2017: £100.0 million) relating to Water Plus's revolving credit facility from United Utilities Water Limited;
- Guarantees with an aggregate limit of £42.5 million (2017: £42.5 million) relating to Water Plus in respect of certain amounts owed to wholesalers, of which £24.0 (2017: £24.0 million) million related to guarantees to United Utilities Water Limited; and
- Performance guarantees with an aggregate limit of £60.3 million (2017: £61.0 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 46 to 49.

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

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. 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. A current tax provision is only recognised when the group has a present obligation as a result of a past event and it is probable that the group will be required to settle that obligation to a taxing authority.

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.

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.

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 'Employee Benefits', 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 pension cost under IAS 19 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.

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

Notes to the financial statements – appendices

A7. Accounting policies (continued)

can be reliably estimated. Expenditure that relates to an existing condition caused by past operations that does not contribute to current or future earnings is expensed.

Foreign currency translation

Transactions and balances

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

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 10 and 11.

	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
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	Non-trading
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	Non-trading
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.