Registered No: 2366678

# United Utilities Water PLC

## Report and Financial Statements

31 March 2012

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# Directors, advisers and other information

**Non-executive directors**
CED Bell
P Heiden
DH Jones
JDG McAdam
NR Salmon
SV Weller

**Executive directors**
JR Houlden
SL Mogford

**Secretary**
SR Gardiner

**Auditor**
KPMG Audit Plc
St James Square
Manchester
M2 6DS

**Registered office**
Haweswater House
Lingley Mere Business Park
Lingley Green Avenue
Great Sankey
Warrington
WA5 3LP

**Terms used in this report:**
United Utilities Water PLC's ultimate parent company is United Utilities Group PLC. 'UUG' means United Utilities Group PLC and 'United Utilities', 'the group' or 'the UUG group' means United Utilities Group PLC and its subsidiary undertakings.

The 'company' or 'UUW' means United Utilities Water PLC. The 'regulated business' or 'regulated activities', means the licensed water and wastewater activities undertaken by United Utilities Water PLC in the North West of England.

**Cautionary statement:**
This report contains certain forward-looking statements with respect to the operations, performance and financial condition of the company. 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 report and the company undertakes no obligation to update these forward-looking statements. Nothing in this report should be construed as a profit forecast.

# Chairman's and Chief Executive Officer's statement

**We are confident that our strategy and renewed focus on operational performance will enable United Utilities Water PLC to create value and deliver our commitments to our customers, shareholder and the environment.**

### Strategy

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

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

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

### Operational performance

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

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

### Delivering our regulatory contract

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

### Customers

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

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

# Chairman's and Chief Executive Officer's statement (continued)

**Regulatory developments**

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

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

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

**Responsible business**

As a board we are responsible to our shareholder, customers and other stakeholders for the performance and long-term success of our company. The way in which we operate, we believe, already reflects the highest standards of corporate governance. We continue to monitor closely new developments and requirements in this area and have updated our statement of responsible business practice, called our Business Principles, this year to ensure these standards underpin our business strategy.

We continue to listen to the views of all our stakeholders and endeavour to develop, manage and operate in an environmentally sustainable, economically beneficial and socially responsible manner. In recognition of UUG's continued focus on responsible business, the UUG retained its 'World Class' rating, as measured by the Dow Jones Sustainability Index. UUG also retained its 'Platinum Plus' ranking in the Business in the Community Corporate Responsibility Index and is proud to be one of only six FTSE 100 companies to hold both.

The communities in which we operate are of great importance to our business and we have continued our investment in these communities of the North West both financially and in terms of employee time through volunteering.

**Our employees**

The people in United Utilities are key to the delivery of the highest levels of service to our customers and we would like again to thank them for their dedication and continued hard work during the year. We believe that a committed, capable and motivated workforce is central to delivering our vision and we remain fully focused on maintaining high levels of employee development and engagement.

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

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

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

# Chairman's and Chief Executive Officer's statement (continued)

**Outlook**

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

JDG McAdam
Chairman
1 June 2012

SL Mogford
Chief Executive Officer
1 June 2012

# Business review

United Utilities Water PLC ('UUW') is a public limited company registered in England and Wales, providing water and wastewater services in North West of England. The company was incorporated in Great Britain on 1 April 1989 under the Companies Act 1985.

UUW is a subsidiary of United Utilities North West Limited (formerly United Utilities North West PLC). The ultimate parent company of UUW is United Utilities Group PLC.

## Business model and strategy

### Our industry

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

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

### The UUG group

UUG is the UK's largest listed water company. The UUG group owns and manages the regulated water and wastewater network in the North West of England, through its subsidiary UUW, which constitutes the vast majority of the group's assets and profit.

### Where the company operates

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

From Crewe to Carlisle, the company keeps the North West flowing through:

- 56,000 hectares of catchment land
- 180 reservoirs
- 94 water treatment works
- 569 wastewater treatment works
- 42,000 km of water pipes
- 76,000 km of sewer pipes
- 4,558 employees

### Water and wastewater operations

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

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

# Business review (continued)

**Water and wastewater operations (continued)**

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

**Our vision**

Our vision is to become:

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

**Our values**

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

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

**Our objectives**

Our aim is to deliver long-term shareholder value:

- The best service to customers - Delivering excellent services to our customers by anticipating and responding to their needs
- At the lowest sustainable cost - Providing our services as effectively as possible at the lowest cost that can be sustained over the long-term
- In a responsible manner - Managing responsibly our relationship with the environment, society, local communities and our employees

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

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

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

**Our approach to doing business**

The company is committed to delivering our services in a responsible way and our approach to responsible business practice is set out in our Business Principles document. This states that for the group, being a responsible business means: providing a great service to our customers; working to protect and enhance our environment; actively supporting our local communities; supporting our employees to achieve their full potential in a safe workplace; and delivering good value to our other stakeholders whilst managing our supply chain fairly.

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

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

# Business review (continued)

**Our approach to doing business (continued)**

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

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

**Other stakeholders:** We are committed to honouring our responsibility to UUG's shareholders, credit investors and those who provide us with goods and services. We aim to operate as effectively as possible at the lowest sustainable cost and to retain a robust and sustainable financial profile to provide enduring shareholder value. We work with suppliers whose business principles, conduct, and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, supporting us in the delivery of wider social, economic and environmental benefits.

Given the long life of our infrastructure, we take a long-term view of our operations and key to the UUG group's strategic objectives is the goal to operate in a more sustainable manner. Sustainability is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. The UUG board-level CR committee develops and oversees our CR strategy and this continuing focus helped the group retain its Dow Jones Sustainability Index 'World Class' rating and its 'Platinum Plus' ranking in the Business in the Community CR Index. Details of our responsible business performance for the year can be found on pages 15 to 28 within the performance section.

**Competitive environment and regulation**

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

**Economic regulation**

Economic regulation is the responsibility of an independent body, Ofwat, whose primary duties are to protect the interests of consumers, to ensure that companies properly carry out their functions and to ensure that companies can finance their functions. As part of its periodic review, Ofwat sets limits on the average annual increase in charges that a water company can impose across each price control period (usually five years).

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

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

# Business review (continued)

**Economic Regulation (continued)**

Based on each company's calculated allowed turnover across the regulatory period, Ofwat publishes annual price limits in its final price determination. The price limits for each company are set by reference to inflation as measured by the retail prices index (RPI), plus an adjustment factor known as 'K'. A company's annual 'K' factor, therefore, shows the amount above or below inflation that it is allowed by Ofwat to change its price by for that financial year.

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

**Our current price limits (published in November 2009)**

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

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

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

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

Every year, all water companies are required to publish details of their annual financial and operational performance. Ofwat uses this information and other data to monitor and compare companies' performance both individually and relative to the other water companies across a wide range of measures. This includes key performance indicators such as Service Incentive Mechanism (SIM), Serviceability and Leakage (see page 27).

**Environmental and quality regulation**

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

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

- the Environment Agency (EA), which is responsible for conserving and redistributing water resources and securing their proper use, including the licensing of water abstraction. The EA also regulates discharges to controlled waters. The EA produces a composite index, measuring the relative annual environmental performance of the 10 water and wastewater companies. This is included as one of our key performance indicators, see page 27;
- the Drinking Water Inspectorate, which enforces drinking water quality standards; and
- Natural England, which is responsible for the protection of designated sites for nature conservation, e.g. Sites of Special Scientific Interest. There is a statutory requirement to manage these sites to protect and enhance biodiversity.

# Business review (continued)

**Environmental and quality regulation (continued)**

Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive and the revised Drinking Water Directive). The impacts of the Natural Environment and Water White Papers, published in 2011, will also affect the regulatory environment in which we operate.

**Competitors**

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

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

In line with our aspiration to be a leading North West service provider, other large service providers in the region are also important companies against which to benchmark performance. In addition, as UUG is a publicly listed FTSE 100 company, the other UK and European listed utilities are competitors from an investment perspective.

**Direct competition**

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

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

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

**Political and regulatory developments**

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

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

# Business review (continued)

**Political and regulatory developments (continued)**

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

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

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

Underpinning all of this, and the plans to increase competition for non-domestic customers, is the need to retain investor confidence in the sector. This is of paramount importance and we are pleased that the strength of the current industry structure will be retained and that the historical regulatory capital value will be protected. Key issues that are currently undergoing industry consultation include possible modifications to water companies' licences and the replacement of the 'costs principle', which governs access pricing, along with Ofwat's proposed average cost to serve methodology for the retail price control. On the matter of licence modifications, we are supportive of the simple changes necessary to implement the government's decision for expanded non-domestic competition and those necessary to facilitate the 2014 review. With regard to the 'costs principle', it is important that, in order to ensure fair network access, that any parliamentary bill or act encourages only efficient entry and protects customers not eligible for competition from cross-subsidy. In respect of retail price controls, we believe it is essential that the regulator continues to take account of regional socio-economic conditions, addresses reporting inconsistencies between companies, retains the RPI inflation link and makes adjustments to reflect the number of customers that receive only water or wastewater services. We will continue with our active involvement on these issues.

**Economic environment**

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

In the UK, RPI inflation has been relatively high over the last couple of years, reaching as high as 5.6 per cent in September 2011. Our turnover and asset base are linked to inflation (as explained in the economic regulation section on page 8), so the high recent levels of inflation have increased our reported turnover and RCV. We also have a large quantity of index-linked debt which means our finance costs increase as inflation rises, providing a partial economic offset to turnover, although it should be noted that both turnover and interest costs are based on differing lagged measures of inflation and so do not provide a perfect hedge.

# Business review (continued)

**Economic environment (continued)**

In the North West, the unemployment rate remained above the national average, reaching 9.6 per cent for the quarter ending March 2012, compared to 8.2 per cent nationally. A report 'Department for Communities and Local Government, Indices of Deprivation 2010', published in March 2011, highlighted that the North West had more of the most deprived areas in England than any other region. As such, particularly in the current difficult economic conditions, bad debt remains a risk to which we are exposed, although Ofwat recognises this through a special factor allowance, and this continues to be a significant area of focus for us.

**Value drivers**

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

Operating in the North West region, the number of customers we serve is relatively stable. Whilst there will be some impact on our turnover due to changes in consumption from our metered customers, the main driver will be from the allowed change in price we charge our customers, which is determined by Ofwat's price control model (as explained in the economic regulation section on page 8).

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

Operating costs are the largest expense to our company and minimising our costs across areas such as employee costs, power, materials, property rates and service costs is important in order to add value to our company. However, minimising costs needs to be done on a sustainable basis and not to the detriment of customer service or long-term value.

In terms of financing costs, Ofwat allows all water companies an industry wide fixed return on debt over the regulatory period in order to efficiently finance their businesses. For the 2010–15 period, this was set at 3.6 per cent plus inflation (pre tax). We can generate financing outperformance by locking-in a lower cost of borrowing than this assumed rate.

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

**Our key performance indicators (KPIs)**

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

# Business review (continued)

**Financial KPIs**

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

| Company objective | KPI | Definition |
|---|---|---|
| Growth | Turnover | A definition of turnover is included in accounting policies (see note 1 of the statutory financial statements) |
| | Regulatory capital expenditure | Total regulatory capital expenditure during the year |
| Delivering significant efficiencies | Underlying operating profit | This underlying measure excludes from the reported operating profit any exceptional operating costs. Reconciliation is shown on page 25 |
| | Underlying profit after taxation | This measure deducts underlying net interest payable and similar charges and underlying taxation from underlying operating profit. Underlying net interest payable and similar charges makes adjustments to the reported net interest payable and similar charges, including the stripping out of fair value movements. Underlying taxation strips out any prior year adjustments, exceptional tax or any deferred tax credits or debits arising from changes in the tax rate from reported taxation. A reconciliation between profit after taxation and underlying profit after taxation is shown on page 25 |
| Robust capital structure | Gearing: net debt to regulatory capital value | The company's net debt (including derivatives) divided by regulatory capital value (Ofwat's published RCV in outturn prices) |

# Business review (continued)

**Operational KPIs**

| Company objective | KPI | Definition | Target |
|---|---|---|---|
| Best service to customers | Serviceability | Ofwat rates each company's assets as 'improving', 'stable', 'marginal' or 'deteriorating' across four categories covering water and wastewater infrastructure and non-infrastructure | To hold at least a stable rating for all four asset classes, which is consistent with Ofwat's target |
| | Service incentive mechanism – qualitative | Ofwat derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 21 water companies. Each company receives a score in the range of zero to five, with five being the highest attainable score | To move to the first quartile in the medium-term |
| | Service incentive mechanism – quantitative | Ofwat derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 21 water companies. Each company receives a SIM point total, where the lowest score represents the best performance | To move to the first quartile in the medium-term |
| Lowest sustainable cost | Opex outperformance | Progress to date on cumulative operating expenditure outperformance versus Ofwat's allowed operating costs over the 2010–15 period | Total opex outperformance over the 2010–15 period of at least £50m |
| | Financing outperformance | Progress to date on financing expenditure outperformance secured versus Ofwat's allowed cost of debt of 3.6% real over the 2010–15 period | Total financing outperformance over the 2010–15 period of at least £300m |
| | Capex outperformance | Capital expenditure progress to date against Ofwat's capital expenditure allowance for the 2010–15 period, after adjusting, through the regulatory methodology, for the impact of construction output prices | To meet Ofwat's revised capital expenditure allowance for the 2010–15 period |
| Responsible manner | Leakage – rolling average annual leakage | Average annual water leakage from network quantified in megalitres per day | To meet our regulatory leakage target, as set by Ofwat, each year |
| | Environment Agency performance assessment | Composite index produced by the Environment Agency, measuring the absolute and relative performance, across a broad range of areas including pollution, of the 10 water and wastewater companies | To move to the first quartile in the medium-term |
| | Dow Jones Sustainability Index rating | Rating awarded to company by Dow Jones using sustainability metrics covering economic, environmental, social and governance performance | To retain UUG's 'World Class' rating each year |

A table showing our KPIs for the current year and their prior year comparators can be found on page 27. Our performance and the progress we have made against our objectives and their associated KPIs are included within the performance section on pages 15 to 27.

# Business review (continued)

## Performance

**Summary**

| | Year ended 31 March 2012 £m | Year ended 31 March 2011 £m |
|---|---|---|
| Underlying operating profit [(1)] | 619.5 | 599.7 |
| Underlying profit before taxation [(1)] | 339.0 | 325.3 |
| Underlying profit after taxation [(1)] | 114.2 | 187.0 |
| Turnover | 1,534.9 | 1,485.5 |
| Operating profit | 596.7 | 587.8 |
| Profit on ordinary activities before taxation | 243.7 | 333.8 |
| Profit after taxation | 120.8 | 279.6 |

[(1)] Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on page 13.

- Further customer service improvements delivered: significantly improved Ofwat SIM scores
- Met regulatory leakage target for sixth consecutive year
- On track to meet regulatory outperformance targets
- Continued progress on capex programme: invested £680 million, an increase of 12 per cent on prior year
- Underlying operating profit of £619.5 million, increase of £19.8 million
- Robust financial position: substantially repaid all term debt due in 2010-15 period

### Operational performance

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

- the best service to customers;
- at the lowest sustainable cost;
- in a responsible manner.

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

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

# Business review (continued)

## Operational performance (continued)

**Best service to customers**

**Actions:**

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

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

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

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

**Wastewater** – The company has a range of actions to help support the serviceability of its wastewater assets. To help reduce sewer flooding, these actions include incident based targeting to focus on areas more likely to experience flooding, effective intervention in cleaning and rehabilitation or refurbishment of sewers and advising customers about items not suitable for sewer disposal. The plan also includes an improved approach to risk assessment to identify and reduce the risk profile of the company's wastewater treatment works.

# Business review (continued)

## Operational performance (continued)

**Key performance indicators:**

**Serviceability** – Long-term stewardship of assets is critical and Ofwat measures this through its serviceability assessment (Ofwat defines serviceability as the capability of a system of assets to deliver a reference level of service to customers and to the environment now and in the future). Ofwat currently assesses one asset class (wastewater non-infrastructure) as 'improving' and two asset classes (water infrastructure and water non-infrastructure) continue to be rated 'stable'. UUW is currently assessed by the regulator as 'marginal' in respect of wastewater infrastructure and the company is implementing an action plan to return this asset class back to a 'stable' rating. The aim is to hold at least a 'stable' rating for all four asset classes, which is aligned with Ofwat's target.

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

**Lowest sustainable cost**

**Actions:**

**Asset optimisation** – Our asset optimisation programme continues to progress well, providing the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power (CHP) assets to improve energy efficiency. The implementation phase is well underway at over half of the 30 sites covered by the programme and a large number of schemes came on line in 2011, with further projects being scoped. The optimisation programme is targeting approximately £9 million of annual savings by 2013/14.

**Proactive asset management** – The company is continuing to introduce a more proactive approach to asset and network management, with the aim of improving our modelling and forecasting to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving efficiency and customer service.

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

**Debt collection** – The company is adopting a more proactive approach to debt collection and has delivered another good performance in the year. We are implementing a detailed action plan, which includes enhancing systems to improve customer segmentation analysis and to obtain better data on customers who have changed address, coupled with a more proactive debt follow up strategy. To support this, a proportion of our debt collection function which was previously off-shored has been brought back in-house and this has helped improve our debt collection performance. Bad debts as a proportion of regulated turnover improved from 2.5 per cent in 2009/10 to 2.1 per cent in 2010/11. The North West faces a particularly tough economic environment with unemployment having increased at a faster rate than any other UK region in 2011/12, particularly in the second half of the year. Despite this, we have again delivered a good performance with bad debts standing at 2.2 per cent of regulated turnover for 2011/12. Debt collection will remain a significant area of focus for the business.

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

# Business review (continued)

## Operational performance (continued)

**Pensions** – The company placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension schemes further. An inflation funding mechanism has been introduced, which has facilitated a move to a lower risk investment strategy with the proportion of pension assets invested in equities or other high risk assets now reduced to around 21 per cent. More prudent longevity assumptions have also been recently introduced. Further details on the company's pension provision are provided in the pensions section on page 24.

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

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

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

# Business review (continued)

for each of these expenditure categories. This lower rate of spend is positive for customers as it should be beneficial to bills at the next price review and, alongside this, we are raising asset standards. It is also beneficial for the group's investors, as costs are lower, a greater proportion of spend should be recoverable and we have the opportunity for additional growth in the regulatory capital value. We are still early into the transfer and will continue to review these cost estimates based on the levels and type of workload and activity experienced and will provide updated forecasts as appropriate.

**Key performance indicators:**

**Financing outperformance** – United Utilities has secured over £300 million of financing outperformance across the 2010–15 period, when compared with Ofwat's allowed cost of debt of 3.6 per cent real, based on an average RPI inflation rate of 2.5 per cent per annum. Should average RPI inflation outturn at 3.5 per cent per annum across the five-year period, this would increase financing outperformance to around £400 million, net of the impact of the pensions inflation funding mechanism. UUW agreed a £200 million index-linked loan with the European Investment Bank (EIB), drawn down between March and May 2011, at an average real interest rate of 1.2 per cent, which secures financing outperformance of around £20 million through to 2015. Subsequently, a further £200 million index-linked loan facility was agreed with the EIB and was drawn down in a number of tranches between November 2011 and March 2012 at an average interest rate of 0.9 per cent real. This is the best rate the company has secured and generates further outperformance of over £15 million through to 2015.

**Operating expenditure outperformance** – The business is targeting total operating expenditure outperformance over the 2010–15 period of at least £50 million, or approximately two per cent, compared with the regulatory allowance. This is in addition to the base operating expenditure efficiency targets set by Ofwat, which equate to a total of approximately £150 million over the five years. UUW is on track to meet its five-year target and has now delivered cumulative operating expenditure outperformance of over £20 million in the first two years of the regulatory period.

**Capital expenditure outperformance** – UUW is delivering significant efficiencies in the area of capital expenditure and expects to meet Ofwat's allowance after adjusting, through the regulatory methodology, for the impact of lower construction output prices. Capital expenditure and the delivery of outputs remain on track.

**Responsible manner**

**Actions:**

**Environment**

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

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

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

# Business review (continued)

## Operational performance (continued)

**Renewable energy** – The company has a detailed carbon and renewable energy plan, which both contributes to sustainability and reduces costs. We are on track to meet our target of a 21 per cent reduction in carbon emissions by 2015 (measured from a 2005/06 baseline). Emissions in 2011/12 were 518,105 tonnes of carbon dioxide equivalent, a reduction of nine per cent on last year. We are now 13 per cent below our baseline position. The company has consistently generated over 100 GWh of renewable electricity annually for the past three years, principally from sludge processing, with renewable energy equating to approximately 14 per cent of the company's total electricity consumption. The company also reduced its energy purchases by over 20 GWh in 2011/12. The company has plans in place to increase renewable energy generation to 125 GWh per annum by 2015.

### Employees

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

### Communities

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

### Key performance indicators:

**Leakage** – The company met its economic level of leakage rolling target for the sixth consecutive year in 2011/12, with a performance of 453 megalitres per day versus the regulatory target of 464 megalitres per day. The aim is to meet our regulatory leakage target each year.

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

**Corporate responsibility** – The group has a strong focus on corporate responsibility and is the only UK water company to have a 'World Class' rating as measured by the Dow Jones Sustainability Index. The group aims to retain this 'World Class' rating each year.

# Business review (continued)

## Financial performance

### Turnover

The company has delivered a good set of financial results for the year ended 31 March 2012. Turnover increased by £49.4 million to £1,534.9 million, principally reflecting a 4.5 per cent nominal (0.2 per cent real price decrease plus 4.7 per cent RPI inflation) regulated price increase, partially offset by the ongoing impact of customers switching to meters and lower commercial volumes. The impact of meter switching was in line with our expectations, although commercial volumes were lower than expected, particularly in the second half of the year when the North West experienced an increase in unemployment. The company would expect to recover the majority of this turnover shortfall through the regulatory methodology at the next price review.

### Underlying operating profit

Underlying operating profit increased by £19.8 million to £619.5 million, primarily as a result of increases in turnover (as explained above), partly offset by increases in property rates, the impact of the transfer of private sewers and the new carbon reduction commitment charge. Reported operating profit increased by £8.9 million, primarily for the reasons outlined above.

### Exceptional operating costs

Exceptional operating costs of £22.8 million have increased by £10.9 million compared to 2010/11 as a result of the recognition of contractual liabilities of £20.2 million, these are pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished. Offsetting these costs is a reduction in one-off restructuring and reorganisation costs of £9.3 million.

### Net interest payable and similar charges

Net interest payable of £353.0 million was £99.0 million higher than last year, principally reflecting £81.4 million of net fair value losses on debt and derivative instruments, compared with £15.1 million of net fair value gains in 2010/11. The £81.4 million net fair value loss in the period is largely due to losses on the regulatory swap portfolio resulting from a significant decrease in sterling interest rates during the period. The company uses these swaps to effectively fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review. The company has continued to benefit from fixing the majority of its remaining debt for the 2010–15 financial period, providing a net effective nominal interest rate of approximately five per cent. Partially offsetting these losses, there has been a net fair value gain during the period due to widening credit spreads in the market, affecting the fair value of our fair value option debt.

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

These offsetting factors resulted in the underlying net interest payable of £280.5 million being flat compared with the prior year.

### Profit before taxation

Underlying profit before taxation was £339.0 million, £13.7 million higher than last year in line with the increase in underlying operating profit. This underlying measure adjusts for the impact of exceptional operating costs and fair value movements in respect of debt and derivative instruments. Reported profit before taxation decreased by 27 per cent to £243.7 million, primarily as a result of net fair value losses on debt and derivative instruments.

# Business review (continued)

## Financial performance (continued)

### Taxation

The current tax charge for 2011/12 was £51.1 million and the current tax effective rate was 20.9 per cent, compared with 12.9 per cent in the prior year. The current tax charge included a £11.6 million credit in relation to the agreement of prior years' tax matters.

The deferred tax charge was £71.8 million compared to £11.3 million charge in the prior year. This includes a £80.9 million credit relating to the changes substantively enacted by the UK government to reduce the mainstream rate of corporation tax from 26 per cent to 24 per cent from 1 April 2012. A deferred tax credit of £74.5 million was also recognised in 2010/11, to reflect a similar two per cent staged reduction in the rate of corporation tax. The principal reason for the increased charge is the movement in the discount for deferred tax.

The tax benefit of £25.4 million relating to pension contributions for deficit funding has been recorded in the statement of total recognised gains and losses, rather than the profit and loss account, as the actuarial movements giving rise to the deficit were previously recorded there. Associated deferred tax movements of £27.3 million are also included in the statement of total recognised gains and losses.

The company made a net cash tax payment during the year of £13.1 million after deducting a £35 million cash tax inflow relating to prior years' tax matters. In the previous year, the company's net tax payment was £68.8 million.

### Profit after taxation

Underlying profit after taxation was £114.2 million. This is based on the underlying profit before taxation figure less an underlying taxation charge of £224.8 million, which includes an adjustment for the deferred tax credit in relation to the change in the mainstream rate of corporation tax and the charge relating to prior years' taxation matters. Reported profit after taxation was £120.8 million compared with £279.6 million last year.

### Cash flow

Net cash inflow from operating activities for the year ended 31 March 2012 was £895.1 million, compared with £942.7 million last year. This reduction reflected the accelerated pension deficit repair payment and an increase in operating costs, partly offset by a rise in turnover. The company's net capital expenditure was £659.0 million.

Net debt including derivatives at 31 March 2012 was £5,629.6 million (2011: £5,166.5 million). This expected increase reflects expenditure on the regulatory capital investment programmes and payments of dividends and interest, alongside the accelerated pension deficit repair payment, partly offset by operating cash flows.

### Debt financing and interest rate management

Gearing (measured as company net debt divided by the company's regulatory capital value) of 65 per cent at 31 March 2012, has increased from 63 per cent at 31 March 2011, and remains within Ofwat's 55 per cent to 65 per cent assumed gearing range. This is the net effect of three main factors: indexation of the principal of the company's index-linked debt, the accelerated pension deficit repair payment and growth in the regulatory capital value. The company's pensions liability has reduced to £40.9 million, on an accounting basis, compared with a deficit of £142.9 million at 31 March 2011. Taking account of this small deficit, and treating it as debt, gearing remains at 65 per cent.

At the year end, UUW had long-term credit ratings of A3/BBB+ from Moody's Investors Service and Standard & Poor's Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies.

# Business review (continued)

## Financial performance (continued)

### Debt financing and interest rate management (continued)

Cash at bank and in hand and current asset investments at 31 March 2012 amounted to £nil million. Between March and May 2011, UUW drew down a £200 million index-linked loan facility with the EIB. The company also renewed £115.0 million of bank facilities during 2011/12. In addition, in November 2011, UUW agreed a further £200 million index-linked loan facility with the EIB which was drawn down between then and March 2012. The company has headroom to cover its projected financing needs into Autumn 2013. The group has access to the international debt capital markets through its €7 billion euro medium-term note programme which provides for the periodic issuance by the company and United Utilities PLC of debt instruments on terms and conditions determined at the time the instruments are issued. The programme does not represent a funding commitment, with funding dependent on the successful issue of the debt securities.

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

Very long-term sterling inflation index-linked debt is the company's preferred form of funding as this provides a natural hedge to assets and earnings. At 31 March 2012, approximately 47 per cent of the company's net debt was in index-linked form, representing around 31 per cent of he company's regulatory capital value, with an average real interest rate of 1.7 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the company's average term debt maturity profile which is in excess of 25 years.

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

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

### Liquidity

Short-term liquidity requirements are met from the company's normal operating cash flow and any short-term bank deposits. The company and United Utilities PLC jointly have a €2 billion euro-commercial paper programme and further liquidity is provided by committed but undrawn credit facilities.

In line with the group board's treasury policy, the company aims to maintain a robust headroom position. Available headroom at 31 March 2012 was £450 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover the company's projected financing needs into Autumn 2013.

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

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

# Business review (continued)

## Financial performance (continued)

### Pensions

As at 31 March 2012, the company had a net retirement benefit, or pension, deficit of £31.1 million, compared with a net pension deficit of £105.7 million at 31 March 2011. This £74.6 million positive movement principally reflects payment of a £79.7 million accelerated deficit repair contribution.

The company has sought to adopt a more sustainable approach to the delivery of pension provision and in advance of the start of the 2010–15 regulatory period amended the terms of its defined benefit pension schemes, the details of which were included in the 2010 UUG annual report and financial statements.

The company stated previously that it would continue to evaluate its pensions investment strategy to de-risk further its pension provision and introduced an inflation funding mechanism (the details of which were included in UUG's 2011 annual report and financial statements), which facilitates a move to a lower risk investment strategy. This has allowed the company to reduce the allocation of its pension assets to 21 per cent in equities and other high risk assets, from 31 per cent at 31 March 2011. In addition, the company has adopted the use of more prudent longevity assumptions. The company has also increased its interest rate hedge to around 65 per cent of pension scheme liabilities. Although any additional payments under this mechanism would reduce financing outperformance, there would be a positive benefit to the pensions surplus or deficit position.

From an accounting perspective, FRS 17 treats the inflation funding mechanism as a schedule of contributions rather than a pension scheme asset. This means that the liabilities position can change to reflect a change in market expectations of long-term inflation, without a commensurate movement in assets. The change in inflation has decreased the present value of the liabilities during the year to 31 March 2012. This accounting treatment means that there is likely to be a degree of volatility in future FRS 17 pension valuations.

Further detail is provided in note 21 to the statutory financial statements.

# Business review (continued)

## Financial performance (continued)

### Underlying profit

In considering the underlying results for the period, the directors have excluded fair value movements on debt and derivative instruments and exceptional operating costs. Reported operating profit and profit before taxation from continuing operations are reconciled to underlying operating profit, underlying profit before taxation and underlying profit after taxation (non-GAAP measures) as follows:

| **Operating profit** | 2012 £m | 2011 £m |
|---|---|---|
| Operating profit per published results | 596.7 | 587.8 |
| Exceptional operating costs * | 22.8 | 11.9 |
| Underlying operating profit | 619.5 | 599.7 |
| **Net interest payable and similar charges** | | |
| Interest payable and other similar charges | (353.2) | (254.2) |
| Interest income | 0.2 | 0.2 |
| Net interest payable and similar charges | (353.0) | (254.0) |
| Net fair value losses/(gains) on debt and derivative instruments | 81.4 | (15.1) |
| Adjustment for interest on swaps and debt under fair value options | (12.1) | (9.5) |
| Adjustment for net pension interest expense | 3.2 | 4.2 |
| Underlying net interest payable and similar charges | (280.5) | (274.4) |
| **Profit before taxation** | | |
| Profit before taxation per published results | 243.7 | 333.8 |
| Exceptional operating costs * | 22.8 | 11.9 |
| Net fair value losses/(gains) on debt and derivative instruments | 81.4 | (15.1) |
| Adjustment for interest on swaps and debt under fair value option | (12.1) | (9.5) |
| Adjustment for net pension interest expense | 3.2 | 4.2 |
| Underlying profit before taxation | 339.0 | 325.3 |
| **Profit after taxation** | | |
| Underlying profit before taxation | 339.0 | 325.3 |
| Reported taxation | (122.9) | (54.2) |
| Deferred taxation credit – change in taxation rate | (80.9) | (74.5) |
| Agreement of prior years' UK taxation matters | 3.8 | (12.0) |
| Taxation relating to underlying profit before taxation adjustments | (24.8) | 2.4 |
| Underlying profit after taxation | 114.2 | 187.0 |

# Business review (continued)

## Financial performance (continued)

### Regulatory accounts measures

| Appointed business only: | 2012 £m | 2011 £m |
|---|---|---|
| Operating profit (historic cost) per published results | 589.8 | 585.7 |
| Exceptional operating costs * | 22.8 | 11.9 |
| Underlying operating profit | 612.6 | 597.6 |

### Atypical operating expenditure items

In accordance with the requirements of Ofwat's Regulatory Accounting Guidelines, atypical items including those items treated as exceptional operating costs under the requirements of UK accounting standards are analysed as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Recognition of contractual liabilities * | 20.2 | - |
| Severance related restructuring costs * | 2.6 | 2.1 |
| Legal provisions | 2.0 | 7.3 |
| Costs to remove concessionary supplies at Oswestry | 1.8 | - |
| Network incidents | 0.8 | - |
| Other reorganisation costs * | - | 7.0 |
| Write off of debt deemed uneconomical to collect | - | 3.3 |
| Pension schemes' curtailment losses arising on reorganisation * | - | 2.8 |
| Costs associated with the Summer 2010 drought | - | 2.4 |
| Costs associated with the Winter 2010 freeze/thaw | - | 1.8 |
| Costs associated with the Wirral flooding | - | 1.6 |
| | 27.4 | 28.3 |

* see note 4 of the statutory financial statements

### Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation

The annual infrastructure renewals charge is based on infrastructure renewals spend for 2011/12, the Company Business Plan for Asset Management Plan (AMP) 5 and the Final Business Plan projections for AMP 6 and AMP 7 covering the period 2010 to 2025. The charge for the year ended 31 March 2012 is £141.6 million (2011: £140.3 million).

The current cost depreciation charge (net of deferred credits) for the year is £382.3 million (2011: £387.6 million). This decrease of £5.3 million is mainly due to the impact higher accelerated depreciation in the year ended 31 March 2011 and the one-off impact in the year ended 31 March 2011 of revising mechanical and electrical asset lives from 1 April 2010, offset by the net increase in the depreciable asset base and the RPI uplift.

### Political and charitable donations

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

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

# Business review (continued)

## Financial performance (continued)

### Political and charitable donations (continued)

Charitable donations by the company in the year amounted to £5,345,093 (2011: £5,193,987). Of this, £5,000,000 went to the United Utilities Trust Fund, an independent grant-making trust helping people facing severe financial challenges, whilst the remainder was in support of local charitable causes and those of interest to employees. The company's other community investments, including in-kind and volunteering time contributions, are described on page 8.

## Key performance indicators

The company monitors a large number of financial and operational key performance indicators (KPIs) to enhance the visibility of its performance and to help drive improvements. Performance in 2011/12 against these KPIs is set out in the table below.

| | 2012 | 2011 |
|---|---|---|
| **Financial KPIs** | | |
| Turnover | £1,534.9m | £1,485.5m |
| Operating profit | £596.7m | £587.8m |
| Profit before tax | £243.7m | £333.8m |
| RCV gearing | 65% | 63% |
| Interest cover | 2.2 | 2.2 |
| **Operational KPIs** | | |
| **Best service to customers** | | |
| Serviceability [1] | 1 x improving, 2x stable, 1x marginal | 1x marginal 3 x stable |
| Service incentive mechanism – qualitative (relative) [2] | 16 | 21 |
| Service incentive mechanism – quantitative (absolute) [3] | 273 | 539 |
| **Lowest sustainable cost** | | |
| Opex outperformance (2010-15 target of at least £50m) | On track | On track |
| Financing outperformance (2010-15 target of at least £300m) | On track | On track |
| Capex outperformance (2010-15 target to meet regulatory allowance) | On track | On track |
| **Responsible manner** | | |
| Leakage – rolling average annual leakage | 453Ml/d – Met target | 464Ml/d – Met target |
| Environment Agency performance assessment [4] | 7th | 6th |
| Dow Jones Sustainability Index rating | 'World Class' | 'World Class' |

[1] 2011/12 ratings subject to regulatory assessment. 2010/11 ratings have been restated from '4x stable' following regulatory assessment.

[2] Performance relative to 21 water companies.

[3] Low number indicates good performance. 2011/12 number subject to regulatory audit.

[4] Performance relative to 10 water and wastewater companies and relating to 2010/11 and 2009/10, being the latest available assessments from the Environment Agency.

# Business review (continued)

## Financial performance (continued)

### Research and development

The company 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.

The company 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 company also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the company was £1.6 million in the year ended 31 March 2012 (2011: £0.9 million).

### Events after the balance sheet date

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2012.

## Principal risks and uncertainties

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

### Key developments during the year

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

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

### Government market reform agenda

#### Risk

The government's White Paper (Water for Life) highlights a number of areas which government will focus on to reform the water industry. These include:

- protecting water and the natural environment;
- tackling water pollution;
- tackling over abstraction;
- water and the green economy;
- reforming and extending competition;
- supporting growth and innovation;
- affordability and bad debt; and
- changing the way we use and value water.

# Business review (continued)

## Principal risks and uncertainties (continued)

### Government market reform agenda (continued)

**Risk (continued)**

A draft Water Bill is expected to be published before Parliament's summer recess, which commences on 18 July 2012, and should deliver many of the aspects set out in the White Paper. Changes to the industry are expected to include extending competition to all non-household customers for both water and wastewater, the removal of barriers to the trading of abstraction licences and facilitating bulk supplies of water, reform of the special merger regime to allow more mergers of water companies and reform of the inset appointment regime. There is also a proposal (in the government's White Paper) to replace the 'costs principle' which underpins network access.

Ofwat plans to consult on the methodology for the 2014 price review in the autumn of 2012.

**Mitigation**

The company has been fully engaged in all government and Ofwat consultations in relation to competition, industry reform and the price setting process.

In respect of competition, a relatively small proportion of the company's profits derive from the retailing of water and wastewater services to non-household customers. If competition is expanded, there would be opportunities for the company to participate in a wider market in England and potentially Scotland. However, we recognise that reforms to the pricing rules that govern access to the company's water network and greater upstream competition could put at risk a greater proportion of the company's profits.

We have raised our concerns with Ofwat and will be proposing an alternative to the 'costs principle', seeking to ensure that key underlying principles (on both cost of entry and efficiency of provision) are reflected in any replacement.

### Future price limits – average cost to serve

**Risk**

It is expected that market reform will result in two price limits, one for retail and one for wholesale. Ofwat proposes to set an average cost to serve for non-contestable customers in the retail price limit. This proposal could result in us having a significant cost recovery shortfall over the next five-year price control period.

**Mitigation**

We have raised and explained our concerns with Ofwat and made alternative proposals as part of the consultation process and continue to make strong representation to Ofwat on this issue, citing the market evidence from investors and analysts to support our case.

### Future price limits – licence modifications

**Risk**

Ofwat has made proposals to modify the licences of the water and wastewater industry to:

- allow it to remove reference to the use of the retail price index (RPI) in price setting; and
- allow flexibility in the number of price limits set and the duration of price controls.

**Mitigation**

All 21 water companies have rejected Ofwat's proposals and the regulator is now consulting with the wider water sector before making its decision on this later in 2012.

# Business review (continued)

## Principal risks and uncertainties (continued)

### Capital investment programmes

**Risk**
The core business requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities.

Delivery of capital investment programmes could be affected by a number of factors including adverse legacy effects of earlier capital investments (such as increased maintenance, repair, reinstatement or renewal costs) or amounts budgeted in prior capital investment programmes proving insufficient to meet the actual amount required. This may affect the company's ability to meet regulatory and other environmental performance standards.

**Mitigation**
Capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for outperformance and any necessary corrective actions.

The UUG's Executive directors are incentivised, as part of their bonusable measures, on time, cost and quality of delivery of our capital investment programme.

### Service incentive mechanism

**Risk**
For the 2010–15 period, Ofwat has introduced a new comparative incentive mechanism to reward or penalise water companies' service performance, replacing the Overall Performance Assessment (OPA). The Service Incentive Mechanism (SIM) compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well they deal with those contacts. Depending on UUW's relative performance under SIM it could receive a turnover penalty (up to one per cent of turnover) or reward (up to 0.5 per cent of turnover) when price limits are next reset in 2014.

**Mitigation**
The company has been monitoring and measuring customer satisfaction for a number of years and results have been improving consistently. We have already improved our SIM score, as detailed in our KPIs. To build on this success, we have a dedicated project team to ensure our processes, behaviours and systems provide consistent and excellent service to our customers. The company's focus is on ensuring right first time service delivery to its customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, then there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. Capital costs of enhanced systems to improve performance are dealt with through the Capital Incentive Scheme. These actions are intended to ensure that the company's performance under SIM is optimised thereby mitigating the risk of a penalty at the next price setting.

### Serviceability assessment

**Risk**
The company is required to maintain the serviceability of its water and wastewater assets, ensuring they continue to deliver a level of service and performance that is at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat deploys a staged approach to regulatory action to secure corrective actions and could make financial adjustments at the next price setting if these actions did not restore service performance. If performance was to continue to decline, the company may incur additional operating or capital expenditure to restore performance.

**Mitigation**
The various indicators of performance are closely and routinely monitored by management. The company's capital investment programme is targeted to seek to maintain stable serviceability of the company's water and wastewater assets. Similarly, operational practice is intended to ensure stable serviceability. Where adverse trends develop and there is a risk of serviceability deviating from stable, then corrective action can be identified and taken.

# Business review (continued)

## Principal risks and uncertainties (continued)

### Pension scheme obligations

**Risk**

The company participates in a number of pension arrangements. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of company finances, with the funds being well diversified and professionally managed. The company's current schemes had a combined FRS 17 'Retirement benefits' net deficit of £31.1 million as at 31 March 2012, compared with a net deficit of £105.7 million as at 31 March 2011.

**Mitigation**

Increases to pension fund deficits may result in an increased liability for the company, the size of the liability depending on a number of factors, including levels of contributions and actuarial assumptions. In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit shown in UUW's final business plan over a 10-year period (subject to reaffirmation at the next price review) for the regulated business and allowed for half of this deficit when setting its overall price controls for the 2010-15 period. In response to the size of its ongoing pension risks and pension costs the company introduced a series of changes for employees in its defined benefit (DB) schemes. These changes, which came into force on 31 March 2010, should result in reduced costs and risks, including deficit, associated with DB liabilities in future. In conjunction with the trustees, the company continues to monitor and look to reduce the investment strategy risks for the pension schemes, including the company's exposure to investment risks.

### Failure to comply with applicable law or regulation

**Risk**

The company is subject to various laws and regulations in the UK. Regulatory authorities may, from time to time, make enquiries of companies within their jurisdiction regarding compliance with regulations governing their operations. In addition to regulatory compliance proceedings, the company could become involved in a range of third party proceedings relating to, for example: land use; environmental protection; health and safety and water quality. Amongst others, these may include civil actions by third parties for infringement of rights or nuisance claims relating to odour or other matters. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous. If the company fails to comply with applicable law or regulations, in particular in relation to its water and wastewater licences, or has not successfully undertaken corrective action, regulatory action could be taken that could include the imposition of a financial penalty (of up to 10 per cent of relevant regulated turnover) or the imposition of an enforcement order requiring the company to incur additional capital or operating expenditure to remedy its non-compliance. In the most extreme cases, non-compliance may lead to revocation of a licence or the appointment of a special administrator.

**Mitigation**

The company endeavours to comply with all legal requirements in accordance with its business principles and robust processes are in place to seek to mitigate against non-compliance. The company continually monitors legislative and regulatory developments and, where appropriate, participates in consultations to seek to influence their outcome, either directly or through industry trade associations for wider issues. The company seeks appropriate funding for any additional compliance costs in the regulated business as part of the price determination process.

# Business review (continued)

## Principal risks and uncertainties (continued)

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

**Risk**

The company controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. The company is also dependent on the ability to access, utilise and communicate remotely via electronic software applications mounted on corporate information technology hardware and communicating through internal and external networks which are not wholly under its control.

In exceptional circumstances, such as prolonged drought, system failure or catastrophic damage, a significant interruption of service provision could occur.

Such consequences may arise due to a number of circumstances either within or outside the company's control. For example from water shortages, the failure of an asset or an element of a network or supporting plant and equipment, human error, an individual's malicious intervention or unavoidable resource shortfalls.

Such instances have a low probability, but if materialised could result in significant loss of life, environmental damage and/or economic and social disruption.

The company could be fined for breaches of statutory obligations or be held liable to third parties or be required to provide an alternative water supply of equivalent quality, which could increase costs.

**Mitigation**

The company operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, alongside related risk management and business continuity procedures which complement the governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Disaster Recovery processes also exist for the recovery of applications, all recognising that possible events can have varying causes, impacts and likelihoods.

Sustainability of our water supply is also managed through regional aqueduct networks which will be enhanced by the West East Link pipeline. While the company seeks to ensure that it has appropriate processes and preventative controls in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of customers, regulators, government and the wider stakeholder community. The company also maintains insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost-effectively. The licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers (by way of interim determination) in the event of a catastrophic incident.

# Business review (continued)

## Principal risks and uncertainties (continued)

### Material litigation

**Risk**

In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against UUW in respect of UUW's discharges of water and treated effluent into the canal. UUW filed a Defence and Counterclaim in support of its believed entitlement to make discharges into the canal without charge and await MSCC's response. Although UUW won a 'summary judgment' application against MSCC in January on a significant element of the claim, MSCC has served notice that it intends to appeal this decision.

**Mitigation**

The company faces the general risk of litigation in connection with its business. In most cases, liability for litigation is difficult to assess or quantify; recovery may be sought for very large and/or indeterminate amounts and the existence and magnitude of liability may remain unknown for substantial periods of time. The company robustly defends litigation, where appropriate, and seeks to minimise its exposure to such claims by early identification of risks and compliance with its legal and other obligations. Based on the facts and matters currently known and the provisions carried in the company's balance sheet, the directors are of the opinion that the possibility of the disputes referred to in this risk section having a material adverse effect on the company's financial position is remote.

# Directors' report

The directors present their report and the audited financial statements of the company for the year ended 31 March 2012.

## Profit and dividends

The results for the year, set out in the profit and loss account on page 43 show that profit for the year after tax was £120.8 million (2011: £279.6 million).

Dividends are only recognised in the financial statements if they are declared and approved in that financial year. Dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date. An interim ordinary dividend of £342.0 million has been declared and paid during the year (2011: £262.2 million).

The directors have not recommended a final ordinary dividend (2011: £nil).

## Regulation

As required by paragraph 3.1 of Condition K of the Instrument of Appointment granted by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Industry Act 1991 ('the Licence'), the directors state that they are satisfied that as at 31 March 2012, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of UUW, the company would have had available to it sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company so that the purpose of the order could have been achieved.

The directors have issued a certificate under Condition F6A of the Licence stating that the company will have available to it sufficient financial and management resources and facilities to enable it to carry out, for at least 12 months, its regulated activities. This certificate also confirms that all contracts entered into with any associated company included all necessary provision and requirements concerning the standard of service to be supplied by the company to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

The contract of appointment with the auditor satisfies the requirements of paragraph 9.2 of Condition F of the Licence, namely that 'the auditor will provide such further explanation or clarification of its reports, and such further information in respect of the matters which are the subject of its reports, as the Director General may reasonably require.

## Business review and principal activities

The company is a wholly owned subsidiary of United Utilities North West Limited (formerly United Utilities North West PLC) and the company's principal activity is the provision of water and wastewater services to customers in the North West of England.

The chairman's and chief executive officer's statement and the business review on pages 3 to 33 reports on the company's activities during the year and on likely future developments. A summary of KPIs can be found in the business review.

The directors of UUW advise that all the information supplied in the chairman's and chief executive officer's statement beginning on page 3 and the business review on pages 6 to 33 is part of the directors' report as incorporated by reference. Any liability for the information is restricted to the extent prescribed in the Companies Act 2006.

## Principal risks

The principal risks and uncertainties are commented on within the business review beginning on page 6.

# Directors' report (continued)

## Political and charitable donations

Details are provided within the business review beginning on page 6.

## Research and development

Details are provided within the business review beginning on page 6.

## Employment policies

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

## Supplier payment policy and practice

Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance. As at 31 March 2012, the average credit period taken for trade purchases was 38 days (2011: 37 days).

## Financial instruments

The risk management objectives and policies of the company in relation to the use of financial instruments can be found in note 20 to the financial statements.

## Directors

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

***Non-executive directors***
CED Bell
P Heiden
DH Jones
JDG McAdam
NR Salmon
SV Weller (appointed 1 March 2012)

***Executive directors***
JR Houlden
SL Mogford

***Company secretary***
SR Gardiner

At no time in the year did any director have a material interest in any contract or arrangement which was significant in relation to the company's business.

## Directors' indemnities and insurance

The company has in place contractual entitlements for directors of the company 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. The company also maintains an appropriate level of directors' and officers' liability insurance.

# Directors' report (continued)

### Disclosure of information to the auditor

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

1. so far as he or she is aware, there is no relevant audit information of which the company's auditor is unaware; and
2. he or she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

### Auditor

During the year Deloitte LLP resigned as auditor of the company and KPMG Audit Plc were appointed.

In accordance with section 489 of the Companies Act 2006, a resolution for the reappointment of KPMG Audit Plc as auditor of the company is to be proposed at the forthcoming Annual General Meeting.

Approved by the board and signed on its behalf by:

JR Houlden
Director
1 June 2012

# Corporate governance report

## The UK Corporate Governance Code

In August 2008, UUW agreed with its regulator, Ofwat (the Water Services Regulation Authority), a Licence amendment that the company should 'have regard to' the UK Corporate Governance Code ('the Code') the current version of which was published by the Financial Reporting Council in June 2010. Following completion of the disposal of all the group's material non-regulated interests in 2010, the company obtained agreement from Ofwat to a new structure that allowed directors to be members of the boards of both the company and its ultimate holding company United Utilities Group PLC in order to increase the efficiency and effectiveness of the corporate governance structure. These changes took place at the end of March 2011 and were in place throughout the year ended 31 March 2012.

As a general rule, the board was minded to have regard to the provisions of Section A ('Leadership')and Section B ('Effectiveness') of the Code in full, subject only to a number of departures which reflect that UUW is a wholly owned subsidiary of a listed company, which itself complies fully with the Code. This report gives details of how those principles of Section A and of Section B of the Code have been applied during the year, any departures from Sections A and B of the Code are fully explained below.

The board also considered the Code provisions of Section C ('Accountability'), Section D ('Remuneration') and Section E ('Relations with Shareholders'). After due consideration, it was concluded that none of these sections were appropriate for UUW. The reasons for the non-application set out on page 40 of Sections C, D and E have been notified to Ofwat.

## The board of directors

The directors who served during the year are set out on page 35. Eight board meetings are scheduled each financial year and the board will meet more or less frequently as required. During the financial year ended 31 March 2012, eight meetings were held (financial year ended 31 March 2011: nine).

A number of additional meetings and telephone conferences were also held during the year. These additional meetings were associated with the company's annual regulatory return submission to Ofwat. The following table shows the attendance of each of the directors at scheduled meetings of the board during the year. The figures in brackets show the maximum number of meetings which the directors could have attended.

| **Board** | |
|---|---|
| Dr C Bell | 8 (8) |
| P Heiden | 8 (8) |
| R Houlden | 8 (8) |
| D Jones | 8 (8) |
| Dr J McAdam | 8 (8) |
| S Mogford | 8 (8) |
| N Salmon | 8 (8) |
| S Weller [(1)] | - (-) |

**Notes:**

[(1)] Sara Weller was appointed to the board on 1 March 2012 and no UUW board meeting was scheduled for March 2012.

# Corporate governance report (continued)

**Summary of approach to governance**

The board members are fully aware of their responsibilities, both individually and collectively, to promote the long-term success of the company as the regulated licence holder within the United Utilities group of companies. The board is responsible for the assessment and management of the key issues and risks impacting the business. The board has a formal schedule of matters reserved to it, which ensures that it takes all major strategy, policy, regulation and investment decisions affecting the company. Accordingly, the board sets the company's overall direction, reviews management performance and reviews the company's approach to business planning, risk management and development of policies including health and safety.

The board is responsible for delivering shareholder value whilst ensuring that the company is managed in accordance with its licensed responsibilities and having regard to other stakeholder interests. Consideration of the long-term interests of the shareholder and bondholders, together with those of the wider interests of stakeholders represented by customers, employees, suppliers, the community, the environment and regulators are factored into the company's management processes. Appropriate consideration is also given, within the company's control and risk assessment processes, to social, environmental and ethical issues.

The board has established a governance framework which encourages all directors to bring to bear independent judgement on issues of strategy, performance and resources. Directors have a right to ensure that any unresolved concerns they have about the running of the company or a proposed action which cannot be resolved are recorded in the board minutes. In addition, upon resignation, a non-executive director would be asked to provide a written statement addressed to the chairman should he or she have any concerns about the running of the company. Any such statement would then be circulated to the board.

The company's governance structure also seeks to ensure that decisions are made at the appropriate level by employees with the knowledge and skills to do so.

The board has formally delegated specific responsibilities to the capital investment committee to consider and approve expenditure and investment proposals within limits determined by the board and the internal control manual. The committee consists of the chief executive officer and the chief financial officer together with members of the senior management team.

During the year, to remove duplication and added administration, UUW's treasury committee was disbanded and instead powers were granted by the board by way of a power of attorney to the chief financial officer and the treasurer to approve borrowing, leasing, bond and other banking facilities. The decisions taken under power of attorney are reported periodically to the UUW board. The treasury committee of the UUG group provides oversight and governance to treasury related matters within UUW.

**Chairman and chief executive director**

Dr John McAdam and Steve Mogford in their respective roles as chairman and chief executive officer of UUG have terms of reference setting out their roles and responsibilities, which included those related to the company.

**Board balance and independence**

During the year, four independent non-executive directors served on the UUW board (in addition to the non-executive chairman and the two executive directors). This exceeded the company's licence obligation of three independent non-executive directors determined by the board to be independent in accordance with the Code. Following the appointment of Sara Weller on 1 March 2012, the number of independent non-executive directors increased to five. The directors have a wide and diverse range of business and other experience and expertise. As stated previously, all the directors of UUW are also directors of UUG. As agreed with Ofwat, the non-executive directors will not be appointed to the board of any other group company.

# Corporate governance report (continued)

**Senior independent director**

Given the company's status as a subsidiary of UUG, the board had previously concluded that it was not appropriate to appoint a senior independent director however, the senior independent director of UUG (Nick Salmon) provides a channel through which any concerns should be raised.

**Conflicts of interest**

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

The directors are at all times fully mindful of the fact that they hold a directorship in both UUW and UUG. Since UUG disposed of the majority of its non-regulated activities, the potential for situations where potential conflicts of interest could arise has significantly diminished. UUG and UUW operate as distinct legal entities. Each board is managed by way of separate agendas, meetings and minutes by the company secretariat and directors are advised in their meetings by the company secretary as appropriate.

**Re-appointment of directors**

Non-executive directors are re-appointed annually reflecting their re-appointment at the UUG annual general meeting, if appropriate. Their appointment or removal would also be subject to provisions contained within the company's articles of association. Any term beyond six years for a non-executive director would be subject to particularly rigorous review, and will take into account the need for progressive refreshing of the board. A separate nomination committee is not appropriate, the succession planning needs of the board are dealt with by the UUG nomination committee.

**Information, support and advice**

Board papers are generally distributed electronically five days in advance of scheduled board meetings to enable directors to obtain a thorough understanding of the matters to be discussed, and seek clarification, if required. During the year, paper copies of board papers were replaced by electronic board packs for directors to use via electronic devices. All directors have access to the advice and services of the company secretary and his team, who are responsible to the board for ensuring that board procedures are complied with. The appointment and removal of the company secretary are matters reserved to the board.

The board has access, through the company secretary, to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. The company also maintains an appropriate level of directors' and officers' insurance.

**Induction and training**

On joining the group, directors receive a tailored induction programme, including an induction pack, time spent with other directors, the company secretary and the executive team. During the year, Steve Mogford's induction continued and an induction programme for Sara Weller was planned and commenced. Directors are provided with details of seminars and training courses relevant to their role and are encouraged to attend those that meet their development needs. Additionally, training was provided to the whole board on topics such as the newly implemented Bribery Act, Competition Law and the UK Corporate Governance Code published by the Financial Reporting Council in June 2010. During the year, the non-executive directors have received training to understand the company's annual regulatory return process and obligations and the evolving reporting requirements to Ofwat in this area. The board also has the opportunity to meet with one of the company's regulators on an annual basis, the Drinking Water Inspectorate (DWI) gave a presentation at the February 2012 board meeting.

# Corporate governance report (continued)

**Performance evaluation**

During the year the UUG board undertook an externally facilitated evaluation of its board, committees and directors as facilitated by Lintstock Limited who are independent from UUG and UUW and have no other connection with the United Utilities group of companies. (For further details please see the corporate governance report within the UUG 2012 annual report). Given the relevance of the evaluation to the individual directors, UUW has not conducted its own evaluation during the year.

**Going concern**

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This conclusion is based on, amongst other matters, a review of the company's financial projections together with a review of the cash and committed borrowing facilities available to the company.

The board also took into account potential contingent liabilities and other risk factors as interpreted by the guidance given in 'Going Concern and liquidity Risk: Guidance for Directors of UK Companies 2009' published by the Financial Reporting Council in October 2009.

**Auditor independence**

The company adheres to the UUG policies on auditor independence which are described in the UUG accounts (available from the address given in note 30). Non-audit services provided to the company must be pre-approved by the UUG audit and risk committee. Non-audit services received during the year ended 31 March 2012 were primarily relating to regulatory work (see note 3).

As described in the 2011 annual report, during the year, UUW changed its auditor from Deloitte LLP to KPMG Audit Plc. The appropriate resolution to approve the reappointment of KPMG Audit Plc as auditor to the company will be put to the shareholder at the forthcoming annual general meeting. There are no contractual obligations restricting the company's choice of external auditor.

## Departures from the Code as notified to Ofwat

**Section C of the Code – Accountability**

UUG has an audit and risk committee and the group has a well resourced internal audit function in place (to which the UUW board has access and which reports to the UUW board on matters such as the company's regulatory returns to Ofwat). Accordingly, the board concluded that having a separate audit and risk committee for the company was unnecessary and duplicative.

**Section D of the Code – Remuneration**

The board concluded that having its own remuneration committee was unnecessary and would not improve governance. The company remunerates its executive directors and senior management subject to the confines of UUG's remuneration policy. (For further details please see the remuneration report within the UUG 2012 annual report). In accordance with their letters of appointment the non-executive directors do not receive any remuneration from the company for their services to the UUW board.

**Section E of the Code – Relations with Shareholders**

As a wholly owned subsidiary of UUG, this provision is not relevant to the company. UUG complies fully with this provision and makes a full disclosure on this in its annual report.

# Statement of directors' responsibilities in respect of the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

# Independent auditor's report

**to the members of United Utilities Water PLC**

We have audited the financial statements of UUW for the year ended 31 March 2012 set out on pages 43 to 80. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

**Respective responsibilities of directors and auditor**
As explained more fully in the Directors' Responsibilities Statement set out on page 41, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

**Scope of the audit of the financial statements**
A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

**Opinion on financial statements**
In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matter prescribed by the Companies Act 2006**
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we are required to report by exception**
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

John Luke (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc
Statutory Auditor
St James Square
Manchester
M2 6DS
1 June 2012

# Profit and loss account

**For the year ended 31 March 2012**

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| **Turnover** | | 1,534.9 | 1,485.5 |
| Total net operating expenses | 3 | (938.2) | (897.7) |
| **Operating profit before exceptional costs *** | | 619.5 | 599.7 |
| Exceptional operating costs | 4 | (22.8) | (11.9) |
| **Operating profit** | | 596.7 | 587.8 |
| Net interest payable and similar charges | 7 | (353.0) | (254.0) |
| **Profit on ordinary activities before taxation** | | 243.7 | 333.8 |
| Taxation charge on profit on ordinary activities | 8 | (122.9) | (54.2) |
| **Profit after taxation** | 23 | 120.8 | 279.6 |

All of the results shown above relate to continuing operations.

* Operating profit before exceptional costs is referred to as underlying operating profit in the business review beginning on page 6.

# Statement of total recognised gains and losses

**For the year ended 31 March 2012**

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| Profit after taxation | 120.8 | 279.6 |
| Actuarial gains on defined benefit pension schemes (see note 21) | 4.3 | 4.4 |
| Taxation on items taken directly to equity (see note 8c) | (1.9) | (1.1) |
| **Total recognised gains and losses for the year** | 123.2 | 282.9 |

# Reconciliation of movements in shareholders' funds

**For the year ended 31 March 2012**

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| Profit after taxation | 120.8 | 279.6 |
| Dividends paid on equity shares (see note 9) | (342.0) | (262.2) |
| Actuarial gains on defined benefit pension schemes (see note 21) | 4.3 | 4.4 |
| Taxation on items taken directly to equity (see note 8c) | (1.9) | (1.1) |
| Net (decrease)/increase in shareholders' funds | (218.8) | 20.7 |
| Opening shareholders' funds | 2,236.1 | 2,215.4 |
| Closing shareholders' funds | 2,017.3 | 2,236.1 |

# Balance sheet

**At 31 March 2012**

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 10 | 8,324.2 | 8,051.8 |
| Investments | 11 | 0.2 | 0.2 |
| | | 8,324.4 | 8,052.0 |
| **Current assets** | | | |
| Stocks | | 5.0 | 4.6 |
| Debtors: amounts falling due within one year | 12a | 378.8 | 311.8 |
| Debtors: amounts falling due after more than one year | 12b | 435.5 | 276.9 |
| Current asset investments | 13 | - | 1.6 |
| Cash at bank and in hand | | - | 0.3 |
| | | 819.3 | 595.2 |
| **Creditors:** amounts falling due within one year | | | |
| Trade and other creditors | 14a | (449.1) | (393.2) |
| Borrowings | 14b | (200.5) | (211.0) |
| | | (649.6) | (604.2) |
| **Net current assets/(liabilities)** | | 169.7 | (9.0) |
| **Total assets less current assets/(liabilities)** | | 8,494.1 | 8,043.0 |
| **Creditors:** amounts falling due after more than one year | | | |
| Trade and other creditors | 15a | (252.2) | (170.7) |
| Borrowings | 15b | (5,788.0) | (5,191.7) |
| | | (6,040.2) | (5,362.4) |
| **Provisions for liabilities** | 17 | (405.5) | (338.8) |
| **Net assets excluding pension liability** | | 2,048.4 | 2,341.8 |
| Pension liability | 21 | (31.1) | (105.7) |
| **Net assets including pension liability** | | 2,017.3 | 2,236.1 |
| **Capital and reserves** | | | |
| Called up share capital | 22, 23 | 1,025.3 | 1,025.3 |
| Share premium account | 22, 23 | 647.8 | 647.8 |
| Profit and loss account | 23 | 344.2 | 563.0 |
| **Shareholders' funds** | | 2,017.3 | 2,236.1 |

The financial statements of United Utilities Water PLC, registered number 2366678, were approved by the board of directors on 1 June 2012 and signed on its behalf by:

JR Houlden
Director

# Cash flow statement

**For the year ended 31 March 2012**

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| **Net cash inflow from operating activities** (see note 25) | 895.1 | 942.7 |
| **Returns on investments and servicing of finance** | | |
| Interest received | 0.1 | 0.2 |
| Interest paid | (167.0) | (162.1) |
| Non-equity dividends paid | (4.6) | (13.6) |
| **Net cash outflow from returns on investments and servicing of finance** | (171.5) | (175.5) |
| **Taxation** | (13.1) | (68.8) |
| **Capital expenditure and financial investment** | | |
| Purchase of tangible fixed assets | (692.0) | (606.0) |
| Grants and contributions received | 31.3 | 22.4 |
| Proceeds from sale of tangible fixed assets | 1.7 | 10.0 |
| **Net cash outflow for capital expenditure and financial investment** | (659.0) | (573.6) |
| **Equity dividends paid** (see note 9) | (342.0) | (262.2) |
| **Cash outflow before management of liquid resources and financing** | (290.5) | (137.4) |
| **Management of liquid resources** | | |
| Decrease/(increase) in short-term deposits | 1.6 | (1.6) |
| **Financing** (see note 27) | 287.5 | 136.7 |
| **Decrease in cash and overdraft in the year** | (1.4) | (2.3) |

# Notes to the financial statements

**At 31 March 2012**

## 1. Accounting policies

The following accounting policies have been applied consistently throughout both the current and prior year.

### Basis of preparation of financial statements

The financial statements of United Utilities Water PLC have been prepared in accordance with applicable United Kingdom accounting standards and, except for the treatment of certain grants and contributions (see below), with the Companies Act 2006. The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments.

### Going concern

The directors have set out factors considered on concluding the appropriateness of the going concern basis of preparation in the going concern section of the corporate governance report.

### Related party transactions

The company has taken advantage of the exemption contained in Financial Reporting Standard 8 'Related party transactions' not to disclose transactions or balances with entities which form part of the group headed by United Utilities Group PLC.

### Turnover

Turnover represents the income receivable in the ordinary course of business for services provided and excludes VAT. This includes the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date.

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

### Research and development

Expenditure on research and development is expensed as incurred.

### Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties and overground plant and equipment). Employee costs that are directly attributable to implementing the capital schemes of the company are capitalised within fixed assets.

*Infrastructure assets*
Infrastructure assets comprise a network of water and wastewater systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls. Expenditure on the infrastructure assets relating to increases in capacity or enhancements of the network are treated as additions, as are asset replacements to maintain the operating capability of the network in accordance with defined standards of service. Additions are included at cost after deducting related grants and contributions. Repairs to infrastructure assets are treated as operating expenditure.

The depreciation charge for infrastructure assets ("Infrastructure Renewals Charge") is the estimated level of annual expenditure required to maintain the operating capability of the network, less the estimated level of relevant annual grants and contributions, which is based on the company's independently certified asset management plan covering a five year period.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

### Tangible fixed assets (continued)

*Other assets*
Additions are included at cost. Freehold land is not depreciated nor are assets in the course of construction until commissioned. 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, which are principally as follows:

- Buildings 10-60 years
- Operational assets 5-80 years
- Fixtures, fittings, tools and equipment (including computer software) 3-40 years

*Carrying value of tangible fixed assets*
The carrying values of tangible fixed assets are reviewed for impairment wherever circumstances indicate that the carrying value of such assets may not be recoverable.

### Grants and contributions

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with the Companies Act 2006 under which the infrastructure assets should be stated at their purchase price or production cost and the capital contributions treated as deferred income and released to the profit and loss account over the useful economic life of the corresponding assets.

The directors are of the opinion that these assets do not have determinable finite useful economic lives and the capital contributions would therefore remain in the balance sheet in perpetuity. The treatment otherwise required by the Accounting Regulations would not present a true and fair view of the company's effective investment in infrastructure assets. The financial effect of this accounting policy is set out in note 10.

Those grants and contributions relating to the maintenance of the operating capability of the infrastructure network are taken into account in determining the depreciation charged for infrastructure assets.

Grants and contributions receivable in respect of other tangible fixed assets are treated as deferred income and released to the profit and loss account over the useful economic lives of the corresponding assets.

### Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases. The company is not currently party to any finance leases.

*Operating leases*
Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

### Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

### Pensions

The company participates in the following pension schemes sponsored by the United Utilities group of companies: the United Utilities Pension Scheme (UUPS) and the United Utilities Group section of the Electricity Supply Pension Scheme (ESPS). UUPS has both a funded defined benefit section and a defined contribution section. The defined contribution section constitutes around 2 per cent of the total asset value of UUPS. ESPS is a funded defined benefit scheme. Both defined benefit schemes are closed to new employees. Under FRS 17 'Retirement benefits', the current service cost is calculated using the projected unit credit method and will therefore normally increase as the members of the scheme approach retirement. The assets of the pension schemes are held in trust funds that are independent of the company's finances.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

**Pensions (continued)**

Actuarial valuations of the defined benefit schemes are performed at intervals of not more than three years and the rates of contribution payable are determined on agreement between the company and the Trustees on the advice of the actuary for each scheme having regard to the results of these actuarial valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates. The last actuarial valuations were carried out as at 31 March 2010.

Defined benefit assets are measured at fair value while liabilities are measured at present value. The difference between the two amounts is recognised as a surplus or obligation in the balance sheet.

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within the profit and loss account within employee costs. The difference between the expected return on scheme assets and interest cost on scheme liabilities is included within the profit and loss account within net interest payable.

The actuarial assumptions adopted are determined by the company after taking advice from its actuarial advisors, Mercer Limited. The actuarial assumptions adopted affect the operating results and profit on ordinary activities before taxation and are disclosed in note 21; they include assumptions for the long-term investment return expected to be achieved on the schemes' assets and the long-term increases expected to apply to pensionable earnings, pension increases and deferred pension increases. Actual experience may differ from the assumptions adopted.

In addition, the company participates in the defined contribution section of the UUPS. Payments are charged to the profit and loss account as employee costs as they fall due. The company has no further payment obligations once the contributions have been paid.

The disclosure requirements of FRS 17 'Retirement benefits' are set out in note 21, together with details of pension and funding arrangements.

**Financial instruments**

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

*Cash and current asset investments*
Cash and current asset investments 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 cash flow statement and related notes, cash is stated net of bank overdraft.

*Financial investments*
Investments (other than short-term deposits) are initially measured at fair value, including transaction costs. Investments classified as available-for-sale 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 debtors*
Trade debtors 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 debtor balance.

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

### Financial instruments (continued)

*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 company after deducting all of its liabilities.

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

*Borrowing costs and finance income*
All borrowing costs and finance income that are not directly attributable to the acquisition, issue or disposal of a financial asset or financial liability are recognised in the profit and loss account in the period in which they are accrued. Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument.

*Borrowings*
The company's default treatment is that bonds, loans and overdrafts are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently measured at amortised cost applying the effective interest method, except where they are designated within a fair value hedge relationship or as fair value through profit or loss. The difference between the net cash proceeds received at inception and the principal cash flows due at maturity is accrued over the term of the borrowing.

*Borrowings designated within a fair value hedge relationship*
Designation is made where it can be demonstrated from inception that a highly effective fair value hedge exists. Where designated, bonds and loans are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently adjusted for any change in fair value attributable to the risk being hedged at each reporting date, with the change being charged or credited to net interest payable in the profit and loss account.

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 net interest payable in the profit and loss account.

*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 net interest payable in the profit and loss account. The company enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note 20).

*Derivatives and borrowings - hedging*
The company's default treatment is that borrowings are carried at amortised cost, whilst associated hedging derivatives are recognised at fair value. This accounting measurement mismatch has the potential to introduce considerable volatility to both the profit and loss account and balance sheet.

Therefore, where feasible, the company takes advantage of the provisions under FRS 26 'Financial Instruments: Recognition and Measurement' to fair value its borrowing instruments to reduce this volatility and better represent the economic hedges that exist between the company's borrowings and associated derivative contracts.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

### Financial instruments (continued)

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

Borrowings are designated at fair value through profit or loss where the designation of such borrowings within a fair value hedge relationship is not feasible despite there being significant fair value offset between the hedged item and the derivative, and where otherwise the inconsistent accounting treatment would result in a significant accounting measurement mismatch.

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

The valuation of debt designated in a fair value hedge relationship is calculated based on the risk being hedged as prescribed by FRS 26 'Financial Instruments: Recognition and Measurement'. The company's policy is to hedge its exposure 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.

### Environmental remediation

Expenditure that relates to an existing condition caused by past operations and does not contribute to current or future earnings is expensed. Liabilities for environmental remediation are recognised and capitalised in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' as appropriate, when there is a legal or constructive obligation, environmental assessments indicate clean-up is probable, and the associated costs can be reliably estimated.

### Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post tax yields to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

Current and deferred taxation is charged or credited in the profit and loss account, except when it relates to items charged or credited to equity, in which case the taxation is also dealt with in equity.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

**Share-based compensation arrangements**

The United Utilities group operates equity-settled and cash-settled share-based compensation plans in the shares of United Utilities Group PLC. In accordance with the transitional provisions, FRS 20 'Share-based Payment' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on estimates of the number of options that are expected to vest. Fair value is based on both simulation and binomial models, according to the relevant measures of performance.

At each balance sheet 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 profit and loss account, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the options are exercised.

## 2. Segmental information

The company operates in the United Kingdom in one class of business, which is the provision of water and wastewater services, therefore no segmental information is required to be disclosed.

## 3. Total net operating expenses

Operating profit is stated after charging/(crediting):

| | 2012 £m | Re-presented * 2011 £m |
|---|---|---|
| **Employee costs (including directors)** | | |
| Wages and salaries | 188.6 | 146.3 |
| Social security costs | 15.8 | 10.6 |
| Post-employment benefits (see below) | 16.4 | 13.6 |
| | 220.8 | 170.5 |
| Less: charged to capital schemes | (92.6) | (62.3) |
| Charged to profit and loss account | 128.2 | 108.2 |

Options over shares of the ultimate parent undertaking, United Utilities Group PLC, have been granted to employees of the company under various schemes. Details of the terms and conditions of each share option scheme are given in the United Utilities Group PLC Annual Report 2012. Included within wages and salaries is an expense of £1.2m (2011: income of £0.1m) relating to a recharge of share-based payment costs/income from the ultimate parent undertaking.

| | | |
|---|---|---|
| **Depreciation** | | |
| Non-infrastructure depreciation | 269.4 | 264.3 |
| Infrastructure depreciation (see note 10) | 139.1 | 141.5 |
| Total depreciation (see note 10) | 408.5 | 405.8 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 3. Total net operating expenses (continued)

| | 2012 £m | Re-presented * 2011 £m |
|---|---|---|
| **Other operating expenses/(income)** | | |
| Hired and contracted services | 126.4 | 125.1 |
| Materials | 54.9 | 39.2 |
| Power | 48.5 | 48.3 |
| Property rates | 78.1 | 67.1 |
| Charge for bad and doubtful debts | 33.5 | 30.2 |
| Loss on disposal of tangible fixed assets | 8.1 | 1.1 |
| Other operating expenses | 31.5 | 63.3 |
| Auditor's remuneration - audit of the company's financial statements | 0.1 | 0.2 |
| Auditor's remuneration - other services (see below) | 0.1 | 0.1 |
| Amortisation of grants and contributions (see note 16) | (6.5) | (6.5) |
| Rents receivable | (1.4) | (1.0) |
| Research and development | 1.6 | 0.9 |
| Operating leases: | | |
| - plant and machinery | 0.8 | 0.7 |
| - land and buildings | 3.0 | 3.1 |
| | 378.7 | 371.8 |
| **Net operating expenses before exceptional costs** | 915.4 | 885.8 |
| Exceptional operating costs (see note 4) | 22.8 | 11.9 |
| **Total net operating expenses** | 938.2 | 897.7 |

* The comparatives have been re-presented to disclose exceptional costs separately (2011: previously presented within net operating expenses).

Fees payable to KPMG Audit Plc for non-audit services during the year were £0.1 million, primarily relating to regulatory reporting (2011: £0.1 million). The 2010/11 costs of £0.3 million relate to services provided by the company's previous auditor, Deloitte LLP.

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

| | 2012 £m | 2011 £m |
|---|---|---|
| Defined benefit expense – current service cost (see note 21) | 12.2 | 10.2 |
| Defined contribution pension costs (see note 21) | 4.2 | 3.4 |
| | 16.4 | 13.6 |

Included in the £4.2 million defined contribution pension costs in 2011/12 are £0.9 million of cash recharges from United Utilities PLC relating to services provided to the company by employees of United Utilities PLC.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 4. Exceptional operating costs

| | 2012 £m | 2011 £m |
|---|---|---|
| Recognition of contractual liabilities * | 20.2 | - |
| Restructuring costs | 2.6 | 2.1 |
| Curtailment losses arising on reorganisation | - | 2.8 |
| Other reorganisation costs | - | 7.0 |
| | 22.8 | 11.9 |

* These are pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished.

## 5. Directors' emoluments

| | 2012 £m | 2011 £m |
|---|---|---|
| Aggregate emoluments in respect of qualifying services | 3.2 | 3.4 |
| Aggregate amounts receivable under long-term incentive plans | - | 0.8 |

| | 2012 Number | 2011 Number |
|---|---|---|
| Number of directors who received shares in respect of qualifying services | 2 | 5 |
| Number of directors who exercised share options | - | 5 |
| Number of directors accruing benefits under defined benefit schemes | - | - |

| | 2012 £m | 2011 £m |
|---|---|---|
| **In respect of the highest paid director** | | |
| Aggregate emoluments | 1.6 | 1.4 |

There were no directors with incentive plans which vested during the year ended 31 March 2012 (2011: two). Details of the employee Sharesave scheme and the executive share option scheme operated by United Utilities Group PLC are given in that company's financial statements.

Both executive directors opted for a cash allowance in lieu of their defined contribution pension entitlement. No non-executive directors were members of the defined benefit section or the defined contribution section of the group's pension scheme during the year, nor were they entitled to a cash allowance in lieu of their defined contribution pension entitlement.

## 6. Employees

| | Average 2012 | Average 2011 |
|---|---|---|
| Number of persons employed during the year | 4,558 | 4,218 |

The 2012 employee costs of £220.8 million disclosed in note 3 include the employee costs relating to the persons employed during the year noted above in addition to amounts recharged to the company of £28.7 million in relation to services provided to UUW by employees of United Utilities PLC. The average number of employees of United Utilities PLC providing services to the company during the year was 495. The costs of these employees were included within other operating costs in the prior year.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 7. Net interest payable and similar charges

| | 2012 £m | 2011 £m |
|---|---|---|
| **Interest payable and similar charges** | | |
| On bank loans, overdraft and other loans | 255.3 | 252.9 |
| On borrowings from parent and fellow subsidiary undertakings | 4.2 | 3.1 |
| **Interest payable before preference share dividends and fair value adjustments** | 259.5 | 256.0 |
| Preference share dividends (see notes 9 and 14b) | 9.1 | 9.1 |
| | 268.6 | 265.1 |
| **Fair value losses/(gains) on debt and derivative instruments** [1] | | |
| Fair value hedge relationships | | |
| - Borrowings | 175.9 | (7.7) |
| - Designated swaps | (172.2) | 2.4 |
| | 3.7 | (5.3) |
| Financial instruments at fair value through profit or loss | | |
| - Borrowings designated at fair value through profit or loss [2] | 19.1 | (0.8) |
| - Held for trading derivatives – economic hedge | (47.9) | 1.1 |
| | (28.8) | 0.3 |
| Held for trading derivatives – 2005-2010 regulatory hedge | - | (7.3) |
| Held for trading derivatives – 2010-2015 regulatory hedge | 74.0 | (11.4) |
| Held for trading derivatives – regulatory hedges > 2015 | 18.2 | - |
| Held for trading derivatives – electricity hedges | 4.6 | - |
| Net payments on swaps and debt under fair value option | 11.4 | 9.3 |
| Held for trading derivatives – other [3] | (2.0) | (3.1) |
| Other | 0.3 | 2.4 |
| **Net fair value losses/(gains)** [4] | 81.4 | (15.1) |
| **Net pension interest expense** (see note 21) | 3.2 | 4.2 |
| **Total interest payable and other similar charges** | 353.2 | 254.2 |
| **Interest income** | | |
| External interest receivable and similar income | (0.2) | (0.2) |
| **Total interest income** | (0.2) | (0.2) |
| **Net interest payable and similar charges** | 353.0 | 254.0 |

[1] Fair value losses/(gains) on debt and derivative instruments includes foreign exchange gains of £23.6 million (2011: £3.8 million losses), excluding those on instruments measured at fair value through profit or loss. These gains/losses are largely offset by fair value gains/losses on derivatives.

[2] Includes £21.3 million of gains (2011: £4.1 million losses) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.

[3] Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.

[4] Includes £12.1 million expense (2011: £9.5 million) due to interest on swaps and debt under fair value option.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 8. Taxation charge on profit on ordinary activities

*(a) Analysis of charge in the year*

| | 2012 £m | 2011 £m |
|---|---|---|
| Current taxation: | | |
| UK corporation tax at 26% (2011: 28%) | 62.7 | 69.0 |
| Adjustment in respect of prior years | (11.6) | (26.1) |
| Total current taxation charge | 51.1 | 42.9 |
| Deferred taxation: | | |
| Origination and reversal of timing differences | 9.6 | 28.1 |
| Decrease in discount | 127.7 | 43.6 |
| Effect of change in rate applied to opening deferred tax balance | (80.9) | (74.5) |
| Adjustment in respect of prior years | 15.4 | 14.1 |
| Total deferred taxation charge | 71.8 | 11.3 |
| **Total taxation charge on profit on ordinary activities** | 122.9 | 54.2 |

The above change in rate figures are calculated based on the undiscounted brought forward balances.

*(b) Factors affecting the current taxation charge for the year*

| | 2012 £m | 2011 £m |
|---|---|---|
| Profit on ordinary activities before taxation | 243.7 | 333.8 |
| UK corporation taxation at 26% (2011: 28%) | 63.4 | 93.5 |
| Capital allowances in excess of depreciation | (24.3) | (27.7) |
| Adjustment in respect of prior years | (11.6) | (26.1) |
| Other timing differences | (11.1) | (2.7) |
| Taxation on items taken directly to equity | 25.4 | - |
| Net non-deductible expenses | 9.3 | 5.9 |
| Actual current taxation charge for the year | 51.1 | 42.9 |

*(c) Taxation on items taken directly to equity*

| | 2012 £m | 2011 £m |
|---|---|---|
| Current taxation: | | |
| Relating to other pension movements | (25.4) | - |
| Deferred taxation: | | |
| On actuarial gains on defined benefit pension schemes | 1.0 | 1.1 |
| Relating to other pension movements | 23.4 | - |
| Change in taxation rate | 2.9 | - |
| | 27.3 | 1.1 |
| Total taxation charge on items taken directly to equity | 1.9 | 1.1 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 9. Dividends

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

| | 2012 £m | 2011 £m |
|---|---|---|
| Interim dividend for the year ended 31 March 2012 at 36.7 pence per share (2011: 28.1 pence per share) | 342.0 | 262.2 |

The directors have not recommended a final ordinary dividend (2011: £nil).

The company's redeemable preference shares are included in the balance sheet as a liability and, accordingly, the dividends payable on them are included in net interest payable (see notes 7 and 14(b)).

## 10. Tangible fixed assets

| | Freehold land and buildings £m | Infra-structure assets £m | Operational assets £m | Fixtures, fittings, tools and equipment £m | Assets in course of construction £m | Total £m |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 April 2011 | 239.6 | 5,363.0 | 5,155.9 | 631.0 | 764.5 | 12,154.0 |
| Additions | 3.7 | 220.1 | 61.1 | 47.7 | 386.5 | 719.1 |
| Grants and contributions | - | (28.4) | - | - | - | (28.4) |
| Transfers | 3.4 | 106.5 | 127.2 | 20.9 | (258.0) | - |
| Disposals | (17.1) | (0.5) | (59.0) | (62.3) | - | (138.9) |
| At 31 March 2012 | 229.6 | 5,660.7 | 5,285.2 | 637.3 | 893.0 | 12,705.8 |
| **Depreciation** | | | | | | |
| At 1 April 2011 | 77.7 | 1,955.3 | 1,683.5 | 385.7 | - | 4,102.2 |
| Charge for the year | 8.2 | 139.1 | 201.9 | 59.3 | - | 408.5 |
| Disposals | (17.0) | - | (54.3) | (57.8) | - | (129.1) |
| At 31 March 2012 | 68.9 | 2,094.4 | 1,831.1 | 387.2 | - | 4,381.6 |
| **Net book value** | | | | | | |
| At 31 March 2012 | 160.7 | 3,566.3 | 3,454.1 | 250.1 | 893.0 | 8,324.2 |
| At 31 March 2011 | 161.9 | 3,407.7 | 3,472.4 | 245.3 | 764.5 | 8,051.8 |

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (see note 1). As a consequence, the cost of tangible fixed assets is £224.2 million (2011: £195.8 million) lower than it would have been had this treatment not been adopted.

| **Capital commitments** | 2012 £m | 2011 £m |
|---|---|---|
| Contracted but not provided for | 395.4 | 241.7 |

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 11. Fixed asset investments

| | Other investments £m |
|---|---|
| Cost and net book value at 1 April 2011 and 31 March 2012 | 0.2 |

Details of other investments, all of which are unlisted unless otherwise stated, held directly by the company and registered in England and Wales, are:

| Other investments | Description of holding | Proportion held | Nature of business |
|---|---|---|---|
| WRc PLC | 'A' Ordinary shares of £1.00 each | 16.97% | Water and wastewater research |
| | 8.0 per cent convertible unsecured loan stock 2014 | 28.58% | |
| Paypoint PLC (listed) | Ordinary shares of 0.003 pence each | 0.05% | Cash collection service |
| Lingley Mere Management Company Limited | Ordinary (non-voting) shares of £1.00 each | 93.27% | Estate management |

The company also has an interest in Rivington Heritage Trust which is limited by guarantee. The company is one of four equal guarantors of Rivington Heritage Trust. Its liability is limited to its guarantee of £1.

The company previously held an investment in United Utilities Water Leasing Limited. An application to have United Utilities Water Leasing Limited struck off was made in August 2011 and it was dissolved on 6 December 2011, no profit or loss was made on dissolution.

## 12. Debtors

### (a) Amounts falling due within one year

| | 2012 £m | 2011 £m |
|---|---|---|
| Trade debtors | 173.5 | 176.9 |
| Amounts owed by parent and fellow subsidiary undertakings – trading balances | 2.6 | 1.9 |
| Amounts owed by parent and fellow subsidiary undertakings – floating rate loans | 40.0 | 40.0 |
| Other debtors | 13.9 | 13.6 |
| Prepayments and accrued income | 99.0 | 77.4 |
| Derivative financial instruments (see note 20) | 49.8 | 2.0 |
| | 378.8 | 311.8 |

### (b) Amounts falling due after more than one year

| | 2012 £m | 2011 £m |
|---|---|---|
| Derivative financial instruments (see note 20) | 435.5 | 276.9 |

## 13. Current asset investments

| | 2012 £m | 2011 £m |
|---|---|---|
| Short-term deposits | - | 1.6 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 14. Creditors: amounts falling due within one year

### (a) Trade and other creditors

| | 2012 £m | 2011 £m |
|---|---|---|
| Trade creditors | 36.0 | 31.9 |
| Amounts owed to parent and fellow subsidiary undertakings | 9.8 | 29.0 |
| Taxation and social security | 48.0 | 34.4 |
| Deferred grants and contributions (see note 16) | 6.4 | 6.4 |
| Accruals and deferred income | 348.9 | 291.5 |
| | 449.1 | 393.2 |

### (b) Borrowings

| | 2012 £m | 2011 £m |
|---|---|---|
| Bonds, bank and other term borrowings | 41.3 | 50.3 |
| Bank overdraft | 8.5 | 7.4 |
| 130,000,000 7.0 per cent £1.00 redeemable preference shares | 130.0 | 130.0 |
| Amounts owed to parent and fellow subsidiary undertakings | 20.7 | 23.3 |
| | 200.5 | 211.0 |

The £130.0 million 7.0 per cent redeemable preference shares have been presented as amounts falling due within one year as they may be redeemed by not less than 30 days' written notice served by the company or the shareholder. Preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the company. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the company. The preference shares have a latest redemption date of 1 October 2099. Further information on the company's borrowings is given in note 19.

## 15. Creditors: amounts falling due after more than one year

### (a) Trade and other creditors

| | 2012 £m | 2011 £m |
|---|---|---|
| Other creditors | 11.4 | 8.1 |
| Deferred grants and contributions (see note 16) | 74.4 | 78.0 |
| Derivative financial instruments (see note 20) | 166.4 | 84.6 |
| | 252.2 | 170.7 |

### (b) Borrowings

| | 2012 £m | 2011 £m |
|---|---|---|
| Bonds, bank and other term borrowings | 4,974.8 | 4,497.2 |
| Amounts owed to parent and fellow subsidiary undertakings | 813.2 | 694.5 |
| | 5,788.0 | 5,191.7 |

Further information on the company's borrowings is given in note 19.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 16. Deferred grants and contributions

| | 2012 £m | 2011 £m |
|---|---|---|
| At the start of the year | 84.4 | 86.9 |
| Received in the year | 2.9 | 4.0 |
| Credited to the profit and loss account (see note 3) | (6.5) | (6.5) |
| At the end of the year | 80.8 | 84.4 |
| Represented by: | | |
| Amounts falling due within one year (see note 14a) | 6.4 | 6.4 |
| Amounts falling due after one year (see note 15a) | 74.4 | 78.0 |
| At the end of the year | 80.8 | 84.4 |

## 17. Provisions for liabilities

| | Deferred tax: pension (note 21) £m | Deferred tax: other (note 18) £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 April 2011 | - | 325.7 | 13.1 | 338.8 |
| At 1 April 2011 – disclosed separately in pensions (see note 21) | (37.2) | - | - | (37.2) |
| Charged/(credited) to profit and loss account | 0.1 | 71.7 | (0.5) | 71.3 |
| | (37.1) | 397.4 | 12.6 | 372.9 |
| Taxation charge on items taken directly to equity | 27.3 | - | - | 27.3 |
| Utilised in the year | - | - | (4.5) | (4.5) |
| At 31 March 2012 – disclosed separately in pensions (see note 21) | 9.8 | - | - | 9.8 |
| At 31 March 2012 | - | 397.4 | 8.1 | 405.5 |

Other provisions principally relate to contractual and legal claims against the company and represents management's best estimate of the value of settlement and costs, the timing is dependent on resolution of the relevant legal claims.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 18. Deferred tax

Deferred tax is provided as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Accelerated capital allowances | 1,003.5 | 1,049.7 |
| Short-term timing differences | (24.5) | (14.7) |
| **Undiscounted provision for deferred tax** | 979.0 | 1,035.0 |
| Discount | (581.6) | (709.3) |
| **Discounted provision for deferred tax (see note 17)** | 397.4 | 325.7 |

## 19. Borrowings

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

| | 2012 £m | 2011 £m |
|---|---|---|
| ***Non-current liabilities*** | | |
| Bonds | 3,765.8 | 3,529.9 |
| Bank and other term borrowings | 1,209.0 | 967.3 |
| Amounts owed to parent and fellow subsidiary undertakings | 813.2 | 694.5 |
| | 5,788.0 | 5,191.7 |
| ***Current liabilities*** | | |
| Bonds, bank and other term borrowings | 41.3 | 50.3 |
| Bank overdraft | 8.5 | 7.4 |
| 130,000,000 7 per cent £1.00 redeemable preference shares | 130.0 | 130.0 |
| Amounts owed to parent and fellow subsidiary undertakings | 20.7 | 23.3 |
| | 200.5 | 211.0 |
| | 5,988.5 | 5,402.7 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 19. Borrowings (continued)

### Terms and debt repayment schedule

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

| | Currency | Year of final repayment | 2012 Fair value | 2012 Carrying value | 2011 Fair value | 2011 Carrying value |
|---|---|---|---|---|---|---|
| | | | £m | £m | £m | £m |
| **Borrowings in fair value hedge relationships** | | | | | | |
| 5.625% 300m bond | GBP | 2027 | 340.9 | 377.8 | 310.2 | 327.7 |
| 5.75% 375m bond | GBP | 2022 | 430.4 | 421.6 | 390.7 | 371.6 |
| 5.375% 150m bond | GBP | 2018 | 177.1 | 176.1 | 163.8 | 162.8 |
| 5.00% 200m bond | GBP | 2035 | 202.1 | 244.6 | 186.3 | 208.2 |
| 4.25% 500m bond | EUR | 2020 | 460.1 | 471.7 | 436.2 | 452.0 |
| 5.02% JPY 10,000m dual currency loan | JPY/USD | 2029 | 76.7 | 95.6 | 73.5 | 87.9 |
| **Borrowings designated at fair value through profit or loss** | | | | | | |
| 6.875% 400m bond (owed to intermediate parent undertaking) | USD | 2028 | 283.3 | 283.3 | 264.3 | 264.3 |
| 1.135% 3,000m bond | JPY | 2013 | 22.6 | 22.6 | 22.5 | 22.5 |
| **Borrowings measured at amortised cost** | | | | | | |
| 1.5802% + RPI 100m IL bond | GBP | 2042 | 116.7 | 122.1 | 102.8 | 116.3 |
| 1.7829% + RPI 100m IL bond | GBP | 2040 | 123.6 | 122.5 | 109.5 | 116.7 |
| 1.9799% + RPI 100m IL bond | GBP | 2035 | 128.3 | 123.8 | 115.3 | 117.9 |
| 3.375% + RPI 50m IL bond | GBP | 2032 | 86.3 | 65.8 | 79.1 | 62.6 |
| 1.3258% + RPI 50m IL bond | GBP | 2041 | 55.1 | 61.1 | 48.5 | 58.2 |
| 1.397% + RPI 50m IL bond | GBP | 2046 | 55.4 | 61.1 | 48.2 | 58.2 |
| 1.3805% + RPI 35m IL bond | GBP | 2056 | 36.5 | 41.7 | 28.5 | 40.1 |
| 1.435% + RPI 50m IL bond | GBP | 2056 | 53.1 | 59.6 | 41.6 | 57.3 |
| 1.556% + RPI 50m IL bond | GBP | 2056 | 55.6 | 59.8 | 43.5 | 57.5 |
| 1.5865% + RPI 50m IL bond | GBP | 2056 | 56.2 | 60.1 | 43.7 | 57.8 |
| 1.591% + RPI 25m IL bond | GBP | 2056 | 28.0 | 30.0 | 21.8 | 28.8 |
| 1.662% + RPI 100m IL bond | GBP | 2056 | 115.2 | 120.3 | 89.7 | 115.7 |
| 1.815% + RPI 100m IL bond | GBP | 2056 | 121.1 | 120.5 | 94.3 | 115.9 |
| 1.847% + RPI 100m IL bond | GBP | 2056 | 123.0 | 121.0 | 95.4 | 116.4 |
| 1.5366% + RPI 50m IL bond | GBP | 2043 | 58.1 | 60.9 | 51.0 | 58.0 |
| 1.7937% + RPI 50m IL bond | GBP | 2049 | 61.3 | 60.8 | 55.8 | 57.9 |
| 1.585% + RPI 100m IL bond | GBP | 2057 | 108.2 | 115.7 | 87.3 | 111.3 |
| 1.702% + RPI 50m IL bond | GBP | 2057 | 56.8 | 58.4 | 45.6 | 56.1 |
| 2.40% + RPI 70m IL bond | GBP | 2039 | 89.1 | 78.1 | 73.8 | 75.1 |
| 1.66% +RPI 35m IL bond | GBP | 2037 | 39.3 | 40.1 | 31.7 | 38.6 |
| 1.97% + RPI 200m IL loan | GBP | 2016 | 255.4 | 240.5 | 207.0 | 228.5 |
| 1.61% + RPI 50m IL loan | GBP | 2020 | 61.7 | 54.9 | 51.5 | 52.8 |
| 1.73% + RPI 50m IL loan | GBP | 2020 | 62.2 | 54.8 | 52.0 | 52.7 |
| 1.84% + RPI 50m IL loan | GBP | 2020 | 62.6 | 54.8 | 52.4 | 52.7 |
| 1.88% + RPI 50m IL loan | GBP | 2020 | 62.6 | 54.6 | 52.7 | 52.5 |
| 1.90% + RPI 50m IL loan | GBP | 2020 | 62.9 | 54.7 | 52.8 | 52.6 |
| 1.93% + RPI 50m IL loan | GBP | 2020 | 62.9 | 54.6 | 52.9 | 52.6 |
| 2.10% + RPI 50m IL loan | GBP | 2020 | 63.6 | 54.5 | 53.7 | 52.4 |
| 2.46% + RPI 50m IL loan | GBP | 2020 | 65.4 | 54.5 | 55.3 | 52.5 |
| 1.23% + RPI 50m IL loan | GBP | 2029 | 49.4 | 52.0 | 42.9 | 50.0 |
| 1.29% + RPI 50m IL loan | GBP | 2029 | 49.8 | 51.6 | - | - |
| 1.12% + RPI 50m IL loan | GBP | 2029 | 48.0 | 51.3 | - | - |
| 1.10% + RPI 50m IL loan | GBP | 2029 | 47.8 | 51.2 | - | - |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 19. Borrowings (continued)

| | Currency | Year of final repayment | 2012 Fair value | 2012 Carrying value | 2011 Fair value | 2011 Carrying value |
|---|---|---|---|---|---|---|
| | | | £m | £m | £m | £m |
| **Borrowings measured at amortised cost (continued)** | | | | | | |
| 0.75% + RPI 50m IL loan | GBP | 2029 | 43.9 | 50.1 | - | - |
| 0.76% + RPI 50m IL loan | GBP | 2030 | 43.7 | 49.9 | - | - |
| 1.15% + RPI 50m IL loan | GBP | 2030 | 46.5 | 49.7 | - | - |
| 1.11% + RPI 50m IL loan | GBP | 2030 | 45.2 | 49.9 | - | - |
| 6.125% 425m bond | GBP | 2015 | 489.7 | 429.7 | 472.3 | 430.9 |
| 1.30% + LIBOR 5,000m (floating) bond | JPY | 2017 | 40.9 | 38.3 | 41.0 | 37.8 |
| Long-term bank borrowings - floating | GBP | 2011-12 | - | - | 199.9 | 200.0 |
| Commission for New Towns loan - fixed | GBP | 2053 | 53.1 | 30.1 | 49.9 | 30.4 |
| Short-term bank borrowings - fixed | GBP | 2012 | 41.0 | 41.0 | - | - |
| Preference shares (owed to immediate parent undertaking) | GBP | 2099 | 130.0 | 130.0 | 130.0 | 130.0 |
| Amounts owed to parent and fellow subsidiary undertakings | GBP | Various | 550.6 | 550.6 | 453.5 | 453.5 |
| **Other borrowings** | | | | | | |
| Bank overdrafts | GBP | 2012 | 8.5 | 8.5 | 7.4 | 7.4 |
| | | | 6,007.5 | 5,988.5 | 5,181.8 | 5,402.7 |

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

**Currency:**

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

**Index-linked debt:**

IL Index-linked debt – this debt is adjusted for movements in the Retail Prices Index with reference to a base RPI established at the trade date
RPI The UK general index of retail prices (for all items) as published by the Office of National Statistics (Jan 1987=100)

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments

### Risk management

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

The group treasury committee, a sub-committee of the group board, has responsibility for setting and monitoring the company'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 group 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 group treasury committee, which details the status of compliance with treasury policies and highlights the level of risk against the appropriate risk limits in place.

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

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

### Liquidity risk

The company looks to manage its liquidity risk by maintaining liquidity within a board approved duration range set with reference to overall group policy parameters. Liquidity is actively monitored by the treasury function and is reported monthly to the treasury committee through the operational compliance report.

At 31 March 2012, the company had £775.4 million (2011: £627.2 million) of available liquidity, which comprised £nil million (2011: £1.9 million) cash and short-term deposits and £775.4 million (2011: £625.3 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months and bank overdraft are repayable on demand.

At 31 March, the company had available committed borrowing facilities as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Expiring within one year | 125.0 | 125.0 |
| Expiring after one year but in less than two years [(1)] | 850.0 | 575.0 |
| Expiring after more than two years | 125.0 | 150.0 |
| **Total borrowing facilities** | 1,100.0 | 850.0 |
| Facilities drawn | (324.6) | (224.7) |
| **Undrawn borrowing facilities** | 775.4 | 625.3 |

[(1)] Figure includes £750.0 million (2011: £450.0 million) facility provided by intermediate parent undertaking.

At 31 March 2012, the company had an additional committed borrowing facility of £40 million expiring after more than two years that was not available to be drawn until September 2013.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

### Liquidity risk (continued)

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.

### Maturity analysis

Concentrations of risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the company's financial liabilities with agreed repayment periods and derivatives on an undiscounted basis.

Derivative cash flows have been shown net where there is a contractual agreement to settle on a net basis; otherwise the cash flows are shown gross.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

| At 31 March 2012 | Total[1] £m | Adjustment [2] £m | 1 year or less £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m |
|---|---|---|---|---|---|---|---|---|
| Bonds | 8,996.4 | | 171.2 | 154.0 | 131.7 | 557.6 | 107.6 | 7,874.3 |
| Bank borrowings and other | 1,786.5 | | 33.1 | 25.1 | 25.6 | 36.2 | 328.1 | 1,338.4 |
| Preference shares | 130.0 | | 130.0 | - | - | - | - | - |
| Parent and fellow subsidiary borrowings | 1,285.6 | | 47.9 | 347.8 | 21.9 | 22.8 | 23.6 | 821.6 |
| Adjustment to carrying value | (6,210.0) | (6,210.0) | | | | | | |
| Financial liabilities excluding derivatives and trade and other creditors at amortised cost | 5,988.5 | (6,210.0) | 382.2 | 526.9 | 179.2 | 616.6 | 459.3 | 10,034.3 |
| Derivatives: | | | | | | | | |
| Payable | 740.7 | | 71.0 | 79.1 | 74.0 | 35.5 | 30.1 | 451.0 |
| Receivable | (1,113.6) | | (128.0) | (119.3) | (121.6) | (47.3) | (46.7) | (650.7) |
| Adjustment to carrying value | 54.0 | 54.0 | | | | | | |
| Derivatives – net assets | (318.9) | 54.0 | (57.0) | (40.2) | (47.6) | (11.8) | (16.6) | (199.7) |

| At 31 March 2011 | Total[1] £m | Adjustment [2] £m | 1 year or less £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m |
|---|---|---|---|---|---|---|---|---|
| Bonds | 9,036.6 | | 130.1 | 130.9 | 155.2 | 132.4 | 558.4 | 7,929.6 |
| Bank borrowings and other | 1,482.9 | | 80.7 | 171.5 | 21.1 | 21.5 | 25.9 | 1,162.2 |
| Preference shares | 130.0 | | 130.0 | - | - | - | - | - |
| Parent and fellow subsidiary borrowings | 1,250.6 | | 47.9 | 251.4 | 25.7 | 27.0 | 27.8 | 870.8 |
| Adjustment to carrying value | (6,497.4) | (6,497.4) | - | - | - | - | - | - |
| Financial liabilities excluding derivatives and trade and other creditors at amortised cost | 5,402.7 | (6,497.4) | 388.7 | 553.8 | 202.0 | 180.9 | 612.1 | 9,962.6 |
| Derivatives: | | | | | | | | |
| Payable | 809.4 | | 67.1 | 62.3 | 72.0 | 44.5 | 38.3 | 525.2 |
| Receivable | (1,067.4) | | (79.0) | (84.0) | (100.6) | (84.3) | (44.6) | (674.9) |
| Adjustment to carrying value | 63.7 | 63.7 | | | | | | |
| Derivatives – net assets | (194.3) | 63.7 | (11.9) | (21.7) | (28.6) | (39.8) | (6.3) | (149.7) |

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 2.65 per cent over the life of each bond.

2. The carrying value of debt is calculated following various methods in accordance with FRS 26 'Financial Instruments: Recognition and Measurement' and, therefore, this adjustment converts the undiscounted forecast future cash flows to the carrying value of debt in the balance sheet.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

### Credit risk

Credit risk arises principally from trade finance (the supply of services to customers) and treasury activities (the depositing of cash and holding derivative and foreign exchange instruments). The company does not believe it is exposed to any material concentrations of credit risk.

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

The company's counterparty credit risk is managed on a group wide basis, which comprises a counterparty credit limit and an additional settlement limit to cover intra day gross settlement cash flows. In addition, potential derivative exposure limits are also established to take account of potential future exposure which may arise under derivative transactions. These limits are calculated by reference to a measure of capital and credit ratings of the individual counterparties and are subject to a maximum single counterparty limit. A control mechanism to trigger a review of specific counterparty limits, irrespective of credit rating action, is in place. This entails daily monitoring of counterparty credit default swap levels and/or share price volatility. Credit exposure is monitored daily by the treasury function and is reported monthly to the group treasury committee through the operational compliance report.

At 31 March, the maximum exposure to credit risk for the company is represented by the carrying amount of each financial asset in the balance sheet:

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| Cash at bank and in hand and current asset investments | - | 1.9 |
| Trade and other debtors | 329.0 | 309.8 |
| Derivative financial instruments | 485.3 | 278.9 |
| | 814.3 | 590.6 |

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2012, the company held £41.0 million (2011: £nil million) as collateral in relation to derivative financial instruments (included within borrowings in note 19). In respect of cash and short-term deposits and derivative financial instruments, the company does not have a material exposure to any financial institutions based within the eurozone, with the exception of Germany, and has not experienced any significant credit issues during the financial year.

### Market risk

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

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

### Inflation risk

The company earns an economic return on its RCV, comprising a real return through turnover and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch which potentially exposes the company to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

### Inflation risk (continued)

The company's index-linked borrowings, which are linked to RPI inflation, form an economic hedge of the company's regulatory assets, which are also linked to RPI inflation. In particular, index-linked debt delivers a cash flow benefit compared to nominal debt, as the inflation adjustment on the index-linked liabilities is a deferred cash flow until the maturity of each financial instrument, providing a better match to the inflation adjustment on the regulated assets, which is recognised as a non-cash uplift to the RCV.

In addition, the company's pension obligations also provide an economic hedge of the company's regulatory assets. During the prior year a revised pension scheme funding mechanism was introduced so that future contributions will be flexed for movements in RPI and smoothed over a rolling five year period, providing a natural hedge against any inflationary uplift on the RCV.

The company seeks to manage this risk by identifying opportunities to amend the economic hedge currently in place where deemed necessary subject to relative value.

Inflation risk is reported monthly to the group treasury committee in the operational compliance report.

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

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| Index-linked debt | 2,667.0 | 2,215.7 |

The sensitivity analysis set out below has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2012 and 31 March 2011, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the company's index-linked borrowings.

**Impact on profit before taxation and equity**

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| 1 per cent increase in RPI | (27.2) | (22.6) |
| 1 per cent decrease in RPI | 27.2 | 22.6 |

Brackets denote a reduction in profit.

This table excludes the hedging aspect of the company's regulatory assets which, being fixed assets, are not 'financial assets' as defined by FRS 25 'Financial Instruments: Disclosures and Presentation' and are typically held at cost or deemed cost less accumulated depreciation on the balance sheet. In addition the table excludes the hedging aspect of the company's pension obligation

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

### Interest rate risk

The company's policy is to structure debt in a way that best matches its underlying assets and cash flows. The regulated business earns an economic return on its RCV, comprising a real return through turnover, determined by the real cost of capital fixed by the regulator for each five- year regulatory pricing period, and an inflation return as an uplift to its RCV.

The preferred form of debt, therefore, is sterling index-linked debt which incurs fixed interest, in real terms, and forms a natural hedge of regulatory assets and cash flows.

Where conventional long-term debt is raised in a fixed-rate form, to manage exposure to long-term interest rates, the debt is generally swapped at inception to create a floating rate liability for the term of the liability through the use of interest rate swaps. These instruments are typically designated within a fair value accounting hedge.

To manage exposure to medium-term interest rates, the company has fixed interest costs for a substantial proportion of the company's net debt for the duration of the current five-year regulatory pricing period. During the year, the company revised its interest risk management strategy during the year to now extend the fixing of interest rates out to a 10-year maturity on a reducing balance basis seeking to lock in a rolling average interest rate on the company's nominal liabilities.

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

### Sensitivity analysis

The sensitivity analysis below has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2012 and 31 March 2011, respectively. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

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

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

### Impact on profit before taxation and equity

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| 1 per cent increase in interest rate | 90.8 | 73.1 |
| 1 per cent decrease in interest rate | (97.0) | (77.4) |

Brackets denote a reduction in profit.

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

### Repricing analysis

The following tables categorise the company's borrowings, derivatives and cash deposits on the basis of when they reprice or, if earlier, mature. The £130.0 million redeemable preference shares have been classified as more than five years according to their latest redemption date of 1 October 2099. The repricing analysis demonstrates the company's exposure to floating interest rate risk.

| At 31 March 2012 | Total | 1 year or less | 1-2 years | 2-3 years | 3-4 years | 4-5 years | More than 5 years |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| **Borrowings in fair value hedge relationships** | | | | | | | |
| Fixed rate instruments | 1,787.4 | - | - | - | - | - | 1,787.4 |
| Effect of swaps | - | 1,787.4 | - | - | - | - | (1,787.4) |
| | **1,787.4** | **1,787.4** | **-** | **-** | **-** | **-** | **-** |
| **Borrowings designated at fair value through profit or loss** | | | | | | | |
| Fixed rate instruments | 305.9 | - | 22.6 | - | - | - | 283.3 |
| Effect of swaps | - | 305.9 | (22.6) | - | - | - | (283.3) |
| | **305.9** | **305.9** | **-** | **-** | **-** | **-** | **-** |
| **Borrowings measured at amortised cost** | | | | | | | |
| Fixed rate instruments | 630.8 | 41.3 | 0.3 | 0.3 | 430.1 | 0.4 | 158.4 |
| Floating rate instruments | 597.4 | 597.4 | - | - | - | - | - |
| Index-linked instruments | 2,667.0 | 2,667.0 | - | - | - | - | - |
| | **3,895.2** | **3,305.7** | **0.3** | **0.3** | **430.1** | **0.4** | **158.4** |
| Effect of a fixed interest rate hedge | - | (2,231.3) | - | 854.2 | 300.0 | 325.0 | 752.1 |
| **Total and net borrowings** | **5,988.5** | **3,167.7** | **0.3** | **854.5** | **730.1** | **325.4** | **910.5** |

| At 31 March 2011 | Total | 1 year or less | 1-2 years | 2-3 years | 3-4 years | 4-5 years | More than 5 years |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| **Borrowings in hedge relationships** | | | | | | | |
| Fixed rate instruments | 1,610.2 | - | - | - | - | - | 1,610.2 |
| Effect of swaps | - | 1,610.2 | - | - | - | - | (1,610.2) |
| | **1,610.2** | **1,610.2** | **-** | **-** | **-** | **-** | **-** |
| **Borrowings designated at fair value through profit or loss** | | | | | | | |
| Fixed rate instruments | 286.8 | - | - | 22.5 | - | - | 264.3 |
| Effect of swaps | - | 286.8 | - | (22.5) | - | - | (264.3) |
| | **286.8** | **286.8** | **-** | **-** | **-** | **-** | **-** |
| **Borrowings measured at amortised cost** | | | | | | | |
| Fixed rate instruments | 591.3 | 0.3 | 0.3 | 0.3 | 0.3 | 431.3 | 158.8 |
| Floating rate instruments | 698.7 | 698.7 | - | - | - | - | - |
| Index-linked instruments | 2,215.7 | 2,215.7 | - | - | - | - | - |
| | **3,505.7** | **2,914.7** | **0.3** | **0.3** | **0.3** | **431.3** | **158.8** |
| Effect of a fixed interest rate hedge | - | (2,231.3) | - | - | 1,781.3 | 450.0 | - |
| **Total borrowings** | **5,402.7** | **2,580.4** | **0.3** | **0.3** | **1,781.6** | **881.3** | **158.8** |
| Cash at bank and in hand and current asset investments | (1.9) | (1.9) | **-** | **-** | **-** | **-** | **-** |
| **Net borrowings** | **5,400.8** | **2,578.5** | **0.3** | **0.3** | **1,781.6** | **881.3** | **158.8** |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

**Electricity price risk**
The company is allowed a fixed amount of turnover 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 company to volatility in its operating cash flows. The company's policy, therefore, is to manage this risk by fixing a proportion of electricity prices in a cost effective manner.

During the year, the company extended its hedging policy, through the use of electricity swap contracts, to fix the price of a substantial proportion of its anticipated electricity usage out to the end of the AMP in 2015. Previously, the company had fixed electricity prices for up to two years directly with its energy supplier.

**Sensitivity analysis**
The sensitivity analysis has been prepared on the basis of the amount of electricity swaps in place at the reporting date and as a result, this analysis is not indicative of the years then ended, as this factor would have varied throughout the year.

**Impact on profit before taxation and equity**

| | 2012<br>£m |
|---|---|
| 10 per cent increase in commodity prices | 4.3 |
| 10 per cent decrease in commodity prices | (4.3) |

Brackets denote a reduction in profit.

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

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

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

The company has no material net exposure to movements in currency rates.

**Capital risk management**
The company's objective when managing capital is to maintain a capital structure that enables the company to retain a credit rating of A3 from Moody's Investors Services (Moody's), which the company believes best mirrors the Water Services Regulation Authority's (Ofwat) assumptions in relation to capital structure. The strategy of targeting a credit rating of A3 has been consistently maintained since 2007.

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

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

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

**Capital risk management (continued)**

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

**Fair values**

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

| | 2012 Fair value £m | 2012 Carrying value £m | 2011 Fair value £m | 2011 Carrying value £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| ***Non-current assets*** | | | | |
| Derivative financial instruments: | | | | |
| Fair value hedge derivatives | 302.3 | 302.3 | 180.8 | 180.8 |
| Held for trading derivatives [2] [3] | 133.2 | 133.2 | 96.1 | 96.1 |
| Total non-current assets | 435.5 | 435.5 | 276.9 | 276.9 |
| ***Current assets*** | | | | |
| Cash and short-term deposits | - | - | 1.9 | 1.9 |
| Trade and other debtors | 329.0 | 329.0 | 309.8 | 309.8 |
| Derivative financial instruments: | | | | |
| Fair value hedge derivatives | 48.4 | 48.4 | - | - |
| Held for trading derivatives [2] | 1.4 | 1.4 | 2.0 | 2.0 |
| Total current assets | 378.8 | 378.8 | 313.7 | 313.7 |
| **Financial liabilities** | | | | |
| ***Non-current liabilities*** | | | | |
| Trade and other creditors | (85.8) | (85.8) | (86.1) | (86.1) |
| Borrowings: | | | | |
| Financial liabilities in a hedge relationship | (1,687.3) | (1,787.4) | (1,560.7) | (1,610.2) |
| Financial liabilities designated at fair value through profit or loss | (305.9) | (305.9) | (286.8) | (286.8) |
| Financial liabilities measured at amortised cost | (3,813.8) | (3,694.7) | (3,123.3) | (3,294.7) |
| | (5,807.0) | (5,788.0) | (4,970.8) | (5,191.7) |
| Derivative financial instruments: | | | | |
| Fair value hedge derivatives | - | - | (2.3) | (2.3) |
| Held for trading derivatives [2] [3] | (166.4) | (166.4) | (82.3) | (82.3) |
| Total non-current liabilities | (6,059.2) | (6,040.2) | (5,141.5) | (5,362.4) |
| ***Current liabilities*** | | | | |
| Trade and other creditors | (449.0) | (449.0) | (393.2) | (393.2) |
| Borrowings: | | | | |
| Financial liabilities measured at amortised cost | (200.5) | (200.5) | (211.0) | (211.0) |
| Total current liabilities | (649.5) | (649.5) | (604.2) | (604.2) |
| Adjustment for accrued interest [1] | 36.0 | - | 34.7 | - |
| Net financial liabilities | (5,858.4) | (5,875.4) | (5,120.4) | (5,376.0) |

[1] Fair values quoted include accrued interest of £36.0 million (2011: £34.7 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other creditors. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

[2] Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £134.5 million (2011: £85.3 million).

[3] Includes amount owed to intermediate parent undertaking £6.7 million (2011: £12.8 million owed by parent undertaking).

# Notes to the financial statements (continued)

**At 31 March 2012**

## 20. Financial instruments (continued)

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

In respect of the total change during the year in the fair value of financial liabilities designated as at fair value through profit or loss of £19.1 million loss (2011: £0.8 million gain), a £21.3 million gain (2011: £4.1 million loss) is attributable to changes in own credit risk. The cumulative impact of changes in credit spread was £76.2 million profit (2011: £54.9 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £81.7 million (2011: £62.6 million).

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

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

| | Level 1 £m | Level 2 £m | Level 3 £m | 2012 Total £m |
|---|---|---|---|---|
| **Financial assets at fair value through profit or loss** | | | | |
| Derivative financial assets | - | 485.3 | - | 485.3 |
| **Financial liabilities at fair value through profit or loss** | | | | |
| Derivative financial liabilities | - | (166.4) | - | (166.4) |
| Financial liabilities designated as fair value through profit or loss | - | (305.9) | - | (305.9) |
| | - | 13.0 | - | 13.0 |

There were no transfers between level 1 and 2 during the year.

| | Level 1 £m | Level 2 £m | Level 3 £m | 2011 Total £m |
|---|---|---|---|---|
| **Financial assets at fair value through profit or loss** | | | | |
| Derivative financial assets | - | 278.9 | - | 278.9 |
| **Financial liabilities at fair value through profit or loss** | | | | |
| Derivative financial liabilities | - | (84.6) | - | (84.6) |
| Financial liabilities designated as fair value through profit or loss | - | (286.8) | - | (286.8) |
| | - | (92.5) | - | (92.5) |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 21. Retirement benefits

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

The last actuarial valuations of UUPS and ESPS were carried out as at 31 March 2010. These valuations have been updated to take account of the requirements of FRS 17 'Retirement Benefits' in order to assess the position at 31 March 2012 by projecting forward from the valuation date, and have been performed by an independent actuary, Mercer Limited.

The company made total contributions of £115.0 million (2011: £60.6 million) to its pension schemes for the year ended 31 March 2012.

Included in the contributions above, the company made an accelerated deficit repair contribution of £79.7 million and a £7.0 million inflation funding mechanism payment to UUPS. Details of the inflation mechanism entered into by UUPS with the company as part of a pension de-risking strategy, are included within the 2011 Report and Financial Statements.

Overall, the company expects to contribute around £40.0 million to its defined benefit schemes in the year ending 31 March 2013.

The main financial assumptions used by the actuary were as follows:

| | 2012<br>% p.a. | 2011<br>% p.a. |
|---|---|---|
| Discount rate | 5.00 | 5.50 |
| Expected return on assets – UUPS | 4.45 | 5.65 |
| Expected return on assets – ESPS | 5.00 | 6.10 |
| Pensionable salary growth and pension increases | 3.25 | 3.35 |
| Price inflation | 3.25 | 3.35 |

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

| | 2012<br>years | 2011<br>years |
|---|---|---|
| Retired member – male | 26.5 | 25.1 |
| Non-retired member – male (currently aged 45) | 28.3 | 26.6 |
| Retired member – female | 29.8 | 28.9 |
| Non-retired member – female (currently aged 45) | 31.7 | 30.4 |

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

# Notes to the financial statements (continued)

**At 31 March 2012**

## 21. Retirement benefits (continued)

At 31 March, the fair value of the schemes' assets and liabilities recognised in the balance sheet, and their expected long-term rates of return were as follows:

| | Schemes' assets at 31 March 2012 % | At 31 March 2012 £m | Schemes' assets at 31 March 2011 % | At 31 March 2011 £m |
|---|---|---|---|---|
| Equities | 12.6 | 176.9 | 31.3 | 344.4 |
| Other non-equity growth assets | 8.2 | 114.1 | - | - |
| Gilts | 2.0 | 27.6 | 0.6 | 7.1 |
| Bonds | 61.6 | 861.5 | 49.0 | 540.1 |
| Other | 15.6 | 218.9 | 19.1 | 210.7 |
| Total fair value of assets | 100.0 | 1,399.0 | 100.0 | 1,102.3 |
| Present value of liabilities | | (1,439.9) | | (1,245.2) |
| Pension liability | | (40.9) | | (142.9) |
| Related deferred tax asset (see note 17) | | 9.8 | | 37.2 |
| **Net pension liability** | | (31.1) | | (105.7) |

To develop the expected long-term rate of return on asset assumptions, the company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The company's actual return on schemes' assets was a gain of £225.6 million (2011: £77.2 million).

The assets as at 31 March 2012, in respect of the UUPS, included in the breakdown above, have been allocated to each asset class based on the return the assets are expected to achieve and not based on the physical assets held. The reason for this being that the UUPS has entered into a variety of derivative transactions in order to change the return characteristics of the physical assets held and in order to reduce undesirable market and liability risks.

The 'Other' element of the portfolio is set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, in addition to providing sufficient liquidity to maintain the derivative transactions, is expected to achieve a return in excess of LIBOR.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 21. Retirement benefits (continued)

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

| | 2012 £m | 2011 £m |
|---|---|---|
| At the start of the year | (1,245.2) | (1,195.3) |
| Interest cost on pension schemes' obligations | (67.7) | (67.1) |
| Actuarial losses | (156.8) | (9.9) |
| Curtailments/settlements arising on reorganisation | (1.9) | (0.9) |
| Member contributions | (6.3) | (5.8) |
| Benefits paid | 50.2 | 53.2 |
| Current service cost | (12.2) | (10.2) |
| Business combinations | - | (9.2) |
| At the end of the year | (1,439.9) | (1,245.2) |

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

| | 2012 £m | 2011 £m |
|---|---|---|
| At the start of the year | 1,102.3 | 1,005.6 |
| Expected return on pension schemes' assets | 64.5 | 62.9 |
| Actuarial gains | 161.1 | 14.3 |
| Member contributions | 6.3 | 5.8 |
| Benefits paid | (50.2) | (53.2) |
| Company contributions | 115.0 | 60.6 |
| Business combinations | - | 6.3 |
| At the end of the year | 1,399.0 | 1,102.3 |

The net pension expense before taxation recognised in the profit and loss account in respect of the defined benefit schemes is summarised as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Current service cost | (12.2) | (10.2) |
| Curtailments/settlements arising on reorganisation | (1.9) | (3.8) |
| **Pension expense charged to operating profit** | (14.1) | (14.0) |
| Expected return on pension schemes' assets | 64.5 | 62.9 |
| Interest cost on pension schemes' liabilities | (67.7) | (67.1) |
| **Pension expense charged to net interest payable and similar charges** (see note 7) | (3.2) | (4.2) |
| **Net pension expense charged before taxation** | (17.3) | (18.2) |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 21. Retirement benefits (continued)

The reconciliation of the opening and closing net pension obligations included in the balance sheet is as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| At the start of the year | (142.9) | (189.7) |
| Expense recognised in the profit and loss account | (17.3) | (18.2) |
| Contributions paid | 115.0 | 60.6 |
| Actuarial gains gross of taxation | 4.3 | 4.4 |
| At the end of the year | (40.9) | (142.9) |

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses. At 31 March 2012, a cumulative pre-tax loss of £114.9 million (2011: £119.2 million) had been recorded directly in the statement of total recognised gains and losses.

The history of the schemes for the current and prior years is as follows:

| | 2012 £m | 2011 £m | 2010 £m | 2009 £m | 2008 £m |
|---|---|---|---|---|---|
| Present value of defined benefit obligations | (1,439.9) | (1,245.2) | (1,195.3) | (961.1) | (1,101.2) |
| Fair value of schemes' assets | 1,399.0 | 1,102.3 | 1,005.6 | 797.0 | 1,033.7 |
| Net retirement benefit obligations | (40.9) | (142.9) | (189.7) | (164.1) | (67.5) |
| Experience adjustments on schemes' liabilities (£) | (22.0) | 39.5 | 3.2 | (13.9) | 14.3 |
| Experience adjustments on schemes' assets (£) | 161.1 | 14.3 | 198.6 | (270.6) | (131.4) |

During the year, the company made £4.2 million (2011: £3.4 million) of contributions to defined contribution schemes.

## 22. Called up share capital and share premium account

| | 2012 £m | 2011 £m |
|---|---|---|
| **Allotted and fully paid share capital** | | |
| 931,930,000 ordinary shares of £1.00 each | 931.9 | 931.9 |
| 93,437,000 zero per cent preference shares of £1.00 each | 93.4 | 93.4 |
| 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each | 130.0 | 130.0 |
| | 1,155.3 | 1,155.3 |
| Less: 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each designated as borrowings (see note 19) | (130.0) | (130.0) |
| | 1,025.3 | 1,025.3 |
| **Share premium account** | 647.8 | 647.8 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 22. Called up share capital and share premium account (continued)

Zero per cent preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the company. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the company.

In accordance with FRS 25 'Financial Instruments: Disclosures and Presentation', 130,000,000 7 per cent preference shares of £1.00 each have been recognised as financial liabilities. The 7 per cent preference shares have a redemption date of 1 October 2099. See note 14(b).

## 23. Share capital and reserves

| | Called up share capital £m | Share premium account £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|
| At 1 April 2011 | 1,025.3 | 647.8 | 563.0 | 2,236.1 |
| Profit after taxation | - | - | 120.8 | 120.8 |
| Actuarial gains on defined benefit pension schemes (see note 21) | - | - | 4.3 | 4.3 |
| Taxation on items taken directly to equity (see note 8c) | - | - | (1.9) | (1.9) |
| Dividends paid on equity shares (see note 9) | - | - | (342.0) | (342.0) |
| At 31 March 2012 | 1,025.3 | 647.8 | 344.2 | 2,017.3 |

## 24. Operating lease commitments

The company is committed to make the following payments under non-cancellable leases during the next year:

| | Land and buildings 2012 £m | Plant and machinery 2012 £m | Land and buildings 2011 £m | Plant and machinery 2011 £m |
|---|---|---|---|---|
| Non-cancellable operating leases which expire: | | | | |
| Within one year | 0.1 | 0.2 | 0.3 | 0.1 |
| Between two and five years | 0.8 | 0.6 | 0.2 | 0.5 |
| After five years | 1.7 | - | 2.1 | - |
| | 2.6 | 0.8 | 2.6 | 0.6 |

# Notes to the financial statements (continued)

**At 31 March 2012**

## 25. Reconciliation of operating profit to net cash inflow from operating activities

| | 2012 £m | 2011 £m |
|---|---|---|
| Operating profit | 596.7 | 587.8 |
| Depreciation (see note 3) | 408.5 | 405.8 |
| Amortisation of grants and contributions (see note 3) | (6.5) | (6.5) |
| Loss on disposal of tangible fixed assets (see note 3) | 8.1 | 1.1 |
| Increase in stocks | (0.4) | (0.9) |
| Increase in debtors | (19.1) | (10.8) |
| Increase in creditors | 13.7 | 17.3 |
| Movement in other provisions (including pension liability) | (105.9) | (51.1) |
| Net cash inflow from operating activities | 895.1 | 942.7 |

## 26. Reconciliation of net cash flow to movement in net debt

| | 2012 £m | 2011 £m |
|---|---|---|
| Decrease in cash in the year | (0.3) | - |
| Increase in overdraft in the year | (1.1) | (2.3) |
| Net cash inflow from increase in debt and lease financing | (269.6) | (118.3) |
| Net cash (inflow)/outflow from (decrease)/increase in liquid resources | (1.6) | 1.6 |
| Net cash outflow/(inflow) from derivatives [(1)] | 3.5 | (9.1) |
| Changes in net debt resulting from cash flows | (269.1) | (128.1) |
| Non-cash adjustments | (194.0) | (87.7) |
| Movement in net debt in the year | (463.1) | (215.8) |
| Net debt at 1 April | (5,166.5) | (4,950.7) |
| Net debt at 31 March | (5,629.6) | (5,166.5) |

Non-cash adjustments include fair value movements and indexation.

[(1)] Cash flows on derivatives consist of £0.7 million financing inflow (2011: £0.7 million inflow) (see note 27) and £nil interest inflow (2011: £8.4 million inflow).

## 27. Financing

| | 2012 £m | 2011 £m |
|---|---|---|
| New loans | 1,342.4 | 569.0 |
| Loans repaid | (1,055.6) | (433.0) |
| | 286.8 | 136.0 |
| Financing cash flows on derivatives | 0.7 | 0.7 |
| Net cash inflow from financing | 287.5 | 136.7 |

Included in these cash flows are amounts drawn down and repaid on a loan facility provided by the intermediate parent undertaking.

# Notes to the financial statements (continued)

**At 31 March 2012**

## 28. Analysis of changes in net debt

| | At 1 April 2011 £m | Cash flow £m | Non-cash movements £m | At 31 March 2012 £m |
|---|---|---|---|---|
| Cash | 0.3 | (0.3) | - | - |
| Overdraft | (7.4) | (1.1) | - | (8.5) |
| Parent and fellow subsidiary undertaking loans | 40.0 | - | | 40.0 |
| | 32.9 | (1.4) | - | 31.5 |
| Debt due after one year | (5,191.7) | (231.6) | (364.7) | (5,788.0) |
| Debt due within one year | (203.6) | (38.0) | 49.6 | (192.0) |
| | (5,395.3) | (269.6) | (315.1) | (5,980.0) |
| Current asset investments | 1.6 | (1.6) | - | - |
| Net debt excluding derivatives | (5,360.8) | (272.6) | (315.1) | (5,948.5) |
| Derivatives | 194.3 | 3.5 | 121.1 | 318.9 |
| Net debt including derivatives | (5,166.5) | (269.1) | (194.0) | (5,629.6) |

## 29. Related party transactions

The aggregate disclosable transactions with the related parties of the company were with Lingley Mere Management Company Limited as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Sales of services | 0.1 | 0.2 |
| Purchases of goods and services | 0.3 | 0.3 |

Sales of services to related party were on the company's normal trading terms.

No guarantees have been given or received. No amounts have been written-off during the year (2011: £nil).

## 30. Ultimate parent undertaking and controlling party

The company's immediate parent undertaking is United Utilities North West PLC, a company incorporated in England and Wales.

In the directors' opinion, the company's ultimate parent undertaking and controlling party is United Utilities Group PLC, a company incorporated in England and Wales.

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

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.

# Regulatory accounting information

# Introduction

The Regulatory Accounts on pages 85 to 116 have been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Water Services Regulation Authority ('WSRA').

Turnover, operating profit and net operating assets for the non-appointed business are below the 1 per cent threshold, defined by Regulatory Accounting Guidelines. However, the directors have separated out the figures for the non-appointed business so that the current cost profit and loss account, balance sheet and cash flow statement show the figures for the appointed business only.

The regulatory financial statements should be read in conjunction with the statutory annual report and financial statements which include the business review (pages 6 to 33), which includes information in respect of the company's charitable donations (page 26). In addition the Directors' report (pages 34 to 36) includes a statement as to the disclosure of information to the auditor (page 36) and the dividend policy which also applies to the appointed business (page 5).

**Statement of directors' responsibilities for regulatory information**

Further to the requirements of company law, the directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by the WSRA.

This additionally requires the directors to:

- Confirm that, in their opinion, the company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months.
- Confirm that, in their opinion, the company has sufficient rights and assets, which would enable a special administrator to manage the affairs, business and property of the company.
- Confirm that, in their opinion, the company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the company's obligations as a water and sewerage undertaker.
- Report to the WSRA changes in the company's activities, which may be material in relation to the company's ability to finance its regulated activities.
- Undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length.
- Keep proper accounting records, which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

**Ring fencing**

In the opinion of the directors, the company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year. This relates to the availability of rights and assets in the event of a special administration order.

# Independent auditor's report to the Water Services Regulation Authority and directors of United Utilities Water PLC

We have audited the Regulatory Accounts of United Utilities Water PLC for the year ended 31 March 2012 on pages 85 to 116 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and
- the regulatory current cost accounting statements for the appointed business, comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the accounting policies.

These Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the accounting policies.

This report is made, on terms that have been agreed, solely to the company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewerage undertaker under the Water Industry Act 1991. Our audit work has been undertaken so that we might state to the company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WSRA, for our audit work, for this report or for the opinions we have formed.

**Respective responsibilities of the WSRA, the directors and auditor**

As explained more fully in the statement of directors' responsibilities set out on page 81, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the Regulatory Accounts**

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the Regulatory Accounts. In addition, we read all the financial and non-financial information in the regulatory accounts to identify material inconsistencies with the audited Regulatory Accounts. If we become aware of any apparent misstatements or inconsistencies, we consider the implications for our report.

# Independent auditor's report to the Water Services Regulation Authority and directors of United Utilities Water PLC (continued)

We have not assessed whether the accounting policies are appropriate to the circumstances of the company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

**Opinion on Regulatory Accounts**

In our opinion, the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 91 to 93, the state of the company's affairs at 31 March 2012 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies.

**Basis of preparation**

Without modifying our opinion, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 85 to 87 have been drawn up in accordance with Regulatory Accounting Guideline 3.06, in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given in note 11 on pages 111 to 113.

**Opinion on other matters prescribed by Condition F**

Under the terms of our contract, we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.

# Independent auditor's report to the Water Services Regulation Authority and directors of United Utilities Water PLC (continued)

**Other matters**

The nature, form and content of Regulatory Accounts are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no such assessment.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2012 on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our 'statutory audit') was made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

KPMG Audit PLC
Chartered Accountants
Manchester, United Kingdom
Date: 1 June 2012

**Notes:**

1. The maintenance and integrity of the company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.

# Historical cost profit and loss account

**For the year ended 31 March 2012**

| | Note | 2012 Appointed £m | 2012 Non-appointed £m | 2012 Total £m | 2011 Appointed £m | 2011 Non-appointed £m | 2011 Total £m |
|---|---|---|---|---|---|---|---|
| **Turnover** | | 1,553.3 | 8.5 | 1,561.8 | 1,506.6 | 8.7 | 1,515.3 |
| Operating costs | | (669.9) | (2.8) | (672.7) | (652.2) | (3.8) | (656.0) |
| Operating costs – exceptional items (a) | 3 | (22.8) | - | (22.8) | (11.9) | - | (11.9) |
| Historical cost depreciation | | (262.7) | (0.1) | (262.8) | (255.7) | (0.1) | (255.8) |
| Operating (expense)/income | | (8.1) | - | (8.1) | (1.1) | - | (1.1) |
| **Operating profit** | | 589.8 | 5.6 | 595.4 | 585.7 | 4.8 | 590.5 |
| Other income | 4 | - | 1.4 | 1.4 | 1.0 | - | 1.0 |
| Net interest | | (353.0) | - | (353.0) | (254.0) | - | (254.0) |
| **Profit on ordinary activities before taxation** | | 236.8 | 7.0 | 243.8 | 332.7 | 4.8 | 337.5 |
| Current tax | | (49.4) | (1.8) | (51.2) | (42.6) | (1.4) | (44.0) |
| Deferred tax | | (72.4) | - | (72.4) | (12.1) | - | (12.1) |
| **Taxation on profit on ordinary activities** | | (121.8) | (1.8) | (123.6) | (54.7) | (1.4) | (56.1) |
| **Profit for the year** | | 115.0 | 5.2 | 120.2 | 278.0 | 3.4 | 281.4 |
| Dividends | | (338.5) | (3.5) | (342.0) | (259.2) | (3.0) | (262.2) |
| **Retained (loss)/profit for the year** | | (223.5) | 1.7 | (221.8) | 18.8 | 0.4 | 19.2 |

Note: Details of reconciling items between the historical cost regulatory accounts and the statutory accounts are provided in note 11.

(a) Historic cost operating profit before exceptional items of £612.6 million (2011: £597.6 million) for the appointed business is stated prior to exceptional costs of £22.8 million (2011: £11.9 million). Exceptional costs comprise pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished of £20.2 million (2011: £nil) and restructuring costs of £2.6 million (2011: £2.1 million). In the prior year, curtailment losses arising on reorganisation of £2.8 million and other reorganisation costs of £7.0 million were recorded. There are no equivalent curtailment losses or other reorganisation costs in the current year.

# Statement of total historical cost recognised gains and losses for the appointed business

**For the year ended 31 March 2012**

| | 2012<br>£m | 2011<br>£m |
|---|---|---|
| Profit for the year (before dividends) | 115.0 | 278.0 |
| Actuarial gains on defined benefit pension schemes (net of deferred taxation taken directly to equity) | 2.4 | 3.3 |
| Total recognised gains and losses for the year | 117.4 | 281.3 |

# Historical cost balance sheet

**At 31 March 2012**

| | 2012 Appointed £m | 2012 Non-appointed £m | 2012 Total £m | 2011 Appointed £m | 2011 Non-appointed £m | 2011 Total £m |
|---|---|---|---|---|---|---|
| **Fixed assets** | | | | | | |
| Tangible fixed assets | 8,253.6 | 1.3 | 8,254.9 | 7,984.0 | 1.2 | 7,985.2 |
| Investments – other | 0.2 | - | 0.2 | 0.2 | - | 0.2 |
| **Total fixed assets** | 8,253.8 | 1.3 | 8,255.1 | 7,984.2 | 1.2 | 7,985.4 |
| **Current assets** | | | | | | |
| Stocks | 5.0 | - | 5.0 | 4.6 | - | 4.6 |
| Debtors | 833.2 | 7.2 | 840.4 | 602.7 | 5.5 | 608.2 |
| Cash | - | - | - | 0.3 | - | 0.3 |
| Short-term deposits | 40.0 | - | 40.0 | 41.6 | - | 41.6 |
| Infrastructure renewals prepayment | 7.4 | - | 7.4 | 7.2 | - | 7.2 |
| **Total current assets** | 885.6 | 7.2 | 892.8 | 656.4 | 5.5 | 661.9 |
| **Creditors: amounts falling due within one year** | | | | | | |
| Overdraft | (8.5) | - | (8.5) | (7.4) | - | (7.4) |
| Creditors | (453.0) | (1.5) | (454.5) | (409.9) | (1.8) | (411.7) |
| Borrowings | (62.0) | - | (62.0) | (73.6) | - | (73.6) |
| Corporation tax payable | (41.7) | (1.8) | (43.5) | (30.8) | (1.4) | (32.2) |
| Preference share dividends payable | (4.6) | - | (4.6) | - | - | - |
| **Total creditors** | (569.8) | (3.3) | (573.1) | (521.7) | (3.2) | (524.9) |
| **Net current assets** | 315.8 | 3.9 | 319.7 | 134.7 | 2.3 | 137.0 |
| **Total assets less current liabilities** | 8,569.6 | 5.2 | 8,574.8 | 8,118.9 | 3.5 | 8,122.4 |
| **Creditors: amounts falling due after one year** | | | | | | |
| Borrowings | (5,788.0) | - | (5,788.0) | (5,191.7) | - | (5,191.7) |
| Other creditors | (177.9) | - | (177.9) | (92.7) | - | (92.7) |
| **Total creditors** | (5,965.9) | - | (5,965.9) | (5,284.4) | - | (5,284.4) |
| **Provisions for liabilities and charges** | | | | | | |
| Deferred tax provision | (387.8) | - | (387.8) | (314.1) | - | (314.1) |
| Other provisions | (8.1) | - | (8.1) | (13.1) | - | (13.1) |
| Deferred income – grants and contributions | (80.8) | - | (80.8) | (84.4) | - | (84.4) |
| Post employment liabilities | (31.1) | - | (31.1) | (105.7) | - | (105.7) |
| **Preference share capital** | (130.0) | - | (130.0) | (130.0) | - | (130.0) |
| **Net assets employed** | 1,965.9 | 5.2 | 1,971.1 | 2,187.2 | 3.5 | 2,190.7 |
| **Capital and reserves** | | | | | | |
| Called up equity share capital | 1,025.3 | - | 1,025.3 | 1,025.4 | - | 1,025.4 |
| Share premium | 647.8 | - | 647.8 | 647.8 | - | 647.8 |
| Profit and loss account | 292.8 | 5.2 | 298.0 | 514.0 | 3.5 | 517.5 |
| **Capital and reserves** | 1,965.9 | 5.2 | 1,971.1 | 2,187.2 | 3.5 | 2,190.7 |

Note: Details of reconciling items between the historical cost regulatory accounts and the statutory accounts are provided in note 11.

# Current cost profit and loss account for the appointed business

**For the year ended 31 March 2012**

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| **Turnover** | 2 | 1,553.3 | 1,506.6 |
| Operating costs | 3 | (1,052.2) | (1,039.8) |
| Operating costs – exceptional items (a) | 3 | (22.8) | (11.9) |
| Operating (expense)/income | 2 | (8.6) | (4.0) |
| | | 469.7 | 450.9 |
| Working capital adjustment | 2, 8 | 2.0 | 1.5 |
| **Current cost operating profit** | | 471.7 | 452.4 |
| Other income | 4 | - | 1.0 |
| Net interest | | (353.0) | (254.0) |
| Financing adjustment | 8 | 111.6 | 167.3 |
| **Current cost profit on ordinary activities before taxation** | | 230.3 | 366.7 |
| Current tax | | (49.4) | (42.6) |
| Deferred tax | | (72.4) | (12.1) |
| **Taxation on current cost profit on ordinary activities** | | (121.8) | (54.7) |
| **Current cost profit attributable to shareholders** | | 108.5 | 312.0 |
| Dividends | | (338.5) | (259.2) |
| **Current cost (loss)/profit retained** | | (230.0) | 52.8 |

(a) Current cost operating profit before exceptional items of £494.5 million (2011: £464.3 million) is stated prior to exceptional costs of £22.8 million (2011: £11.9 million). Exceptional costs comprise pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished of £20.2 million (2011: £nil) and restructuring costs of £2.6 million (2011: £2.1 million). In the prior year, curtailment losses arising on reorganisation of £2.8 million and other reorganisation costs of £7.0 million were recorded. There are no equivalent curtailment losses or other reorganisation costs in the current year.

# Current cost balance sheet for the appointed business

**At 31 March 2012**

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 5 | 76,060.5 | 56,037.5 |
| Third party contributions since 1989/90 * | | (18,442.8) | (553.3) |
| | | 57,617.7 | 55,484.2 |
| Working capital | 7 | (77.5) | (56.3) |
| Cash | | - | 0.3 |
| Short-term deposits | | 40.0 | 41.6 |
| Overdraft | | (8.5) | (7.4) |
| Infrastructure renewals prepayment | | 7.4 | 7.2 |
| **Net operating assets** | | 57,579.1 | 55,469.6 |
| **Non-operating assets and liabilities** | | | |
| Borrowings | | (62.0) | (73.6) |
| Non-trade debtors | | 499.2 | 292.3 |
| Non-trade creditors | | (36.5) | (38.7) |
| Investments – other | | 0.2 | 0.2 |
| Corporation tax payable | | (41.7) | (30.8) |
| Preference share dividends payable | | (4.6) | - |
| **Total non-operating assets and liabilities** | | 354.6 | 149.4 |
| **Creditors: amounts falling due after more than one year** | | | |
| Borrowings | | (5,788.0) | (5,191.7) |
| Other creditors | | (177.9) | (92.7) |
| **Total creditors falling due after more than one year** | | (5,965.9) | (5,284.4) |
| **Provisions for liabilities and charges** | | | |
| Deferred tax provision | | (387.8) | (314.1) |
| Post employment liabilities | | (31.1) | (105.7) |
| Other provisions | | (8.1) | (13.1) |
| **Total provisions** | | (427.0) | (432.9) |
| **Preference share capital** | | (130.0) | (130.0) |
| **Net assets** | | 51,410.8 | 49,771.7 |
| **Capital and reserves** | | | |
| Called up equity share capital | | 1,025.3 | 1,025.4 |
| Share premium | | 647.8 | 647.8 |
| Profit and loss account | | (849.9) | (622.3) |
| Current cost reserve | 8 | 50,587.6 | 48,720.8 |
| **Total capital and reserves** | | 51,410.8 | 49,771.7 |

*see footnote within note 5

# Current cost cash flow statement

**For the year ended 31 March 2012**

| | 2012 Appointed £m | 2012 Non-appointed £m | 2012 Total £m | 2011 Appointed £m | 2011 Non-appointed £m | 2011 Total £m |
|---|---|---|---|---|---|---|
| Current cost operating profit | 471.7 | 7.0 | 478.7 | 452.4 | 4.8 | 457.2 |
| Working capital adjustment | (2.0) | - | (2.0) | (1.5) | - | (1.5) |
| Decrease/(increase) in working capital | 35.8 | (2.2) | 33.6 | 1.4 | 0.3 | 1.7 |
| Receipts from other income | 0.2 | 1.4 | 1.6 | 2.7 | - | 2.7 |
| Current cost depreciation (net of amortisation of deferred contributions) | 382.3 | - | 382.3 | 387.6 | - | 387.6 |
| Current cost loss on sale of fixed assets | 8.6 | - | 8.6 | 4.0 | - | 4.0 |
| Infrastructure renewals charge | 141.6 | - | 141.6 | 140.3 | - | 140.3 |
| Other non-cash profit and loss items | (106.6) | - | (106.6) | (49.8) | - | (49.8) |
| **Net cash inflow from operating activities** | 931.6 | 6.2 | 937.8 | 937.1 | 5.1 | 942.2 |
| **Returns on investments and servicing of finance** | | | | | | |
| Interest received | 0.1 | - | 0.1 | 0.2 | - | 0.2 |
| Interest paid | (167.0) | - | (167.0) | (162.1) | - | (162.1) |
| Non-equity dividends paid | (4.6) | - | (4.6) | (13.6) | - | (13.6) |
| **Net cash outflow from returns on investments and servicing of finance** | (171.5) | - | (171.5) | (175.5) | - | (175.5) |
| **Taxation paid** | (11.7) | (1.4) | (13.1) | (67.8) | (1.0) | (68.8) |
| **Capital expenditure** | | | | | | |
| Gross cost of purchase of fixed assets | (591.6) | (1.3) | (592.9) | (452.9) | (1.1) | (454.0) |
| Receipt of grants and contributions | 31.3 | - | 31.3 | 13.5 | - | 13.5 |
| Infrastructure renewals expenditure | (141.8) | - | (141.8) | (142.1) | - | (142.1) |
| Disposal of fixed assets | 1.7 | - | 1.7 | 9.5 | - | 9.5 |
| **Net cash outflow from investing activities** | (700.4) | (1.3) | (701.7) | (572.0) | (1.1) | (573.1) |
| **Equity dividends paid** | (338.5) | (3.5) | (342.0) | (259.2) | (3.0) | (262.2) |
| **Management of liquid resources** | | | | | | |
| Net cash inflow/(outflow) from management of liquid resources | 1.6 | - | 1.6 | (1.6) | - | (1.6) |
| **Net cash outflow before financing** | (288.9) | - | (288.9) | (139.0) | - | (139.0) |
| **Financing** | | | | | | |
| New bank loans | 1,343.1 | - | 1,343.1 | 569.7 | - | 569.7 |
| Repayment of bank loans | (1,055.6) | - | (1,055.6) | (433.0) | - | (433.0) |
| **Net cash inflow from financing** | 287.5 | - | 287.5 | 136.7 | - | 136.7 |
| **Decrease in cash and overdraft** | (1.4) | - | (1.4) | (2.3) | - | (2.3) |

# Notes to the current cost accounts

**At 31 March 2012**

## 1. Accounting policies

The Regulatory Accounts have been prepared in accordance with the requirements of the Regulatory Accounting Guidelines issued by the Water Services Regulation Authority for the modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance in the context of assets which are valued at their current cost value to the business. The accounting polices adopted, which have been applied consistently during the year and the prior year, are set out below:

**Tangible fixed assets**

Assets in operational use are valued at the replacement cost for current operating capacity. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements by contributions from third parties and to the extent that some of those assets, would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amount.

An Asset Management Plan (AMP) survey of assets existing at 31 March 2008 was undertaken as part of the 2009 Price Review. Adjustments were made to asset values in the fixed asset note in the 2009/10 Regulatory Accounts. In the intervening years, between AMP surveys, values are restated to take account of the general level of inflation as measured by changes in the retail price index (RPI), and any changes agreed with Ofwat following the latest AMP survey.

*Operational assets*

Non specialised operational properties are valued on the basis of open market value for existing use as part of the periodic AMP reviews and are expressed in real terms by indexing using RPI.

Specialised operational assets are valued on the basis of information provided by the AMP. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

*Infrastructure assets*

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost, determined principally on the basis of data provided by the AMP.

*Other fixed assets*

All other fixed assets are valued principally on the basis of data provided by the AMP.

*Surplus land*

Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under Condition B of the Instrument of Appointment.

*Capitalisation policy*

The company's capitalisation policy for the Regulatory Accounts is based on the Regulatory Accounting Guidelines (RAGs) framework, particularly Regulatory Accounting Guideline 2.03 'Guideline for Capitalisation of Expenditure'. Where the RAGs do not address a particular capital accounting issue, UK Generally Accepted Accounting Practice is followed. In summary:

Capital expenditure on each type of asset is categorised by purpose either as:

- base service provision, which is required to maintain the current (most recently established base) level of serviceability to customers; or as
- enhancement where there is a permanent increase in the current level of serviceability to a new "base" level.

Routine and other maintenance expenditure, not included in capital expenditure, is treated as an operating cost and taken directly to the profit and loss account.

*Allocation of fixed assets to business activities*

Fixed assets are allocated directly to the business area to which they relate where possible, as defined in Ofwat's Regulatory Accounting Guideline 4.03. Shared assets are allocated based on an activity basis using quantitative measures reflecting utilisation of the assets.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

**Grants and other third party contributions**

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to turnover. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

**Real financial capital maintenance adjustments**

These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

*Working capital adjustment*

This is calculated by applying the change in RPI over the year to the opening total of trade debtors and stock, less trade creditors.

*Financing adjustment*

This is calculated by applying the change in RPI over the year to the opening balance of net finance, which comprises all assets and liabilities in the balance sheet apart from those included in working capital and excluding fixed assets, deferred taxation provision, index-linked debt and dividends payable.

**Allocation of costs to principal services**

Direct costs are charged to the sub-service areas to which they are attributable, as defined in Ofwat's Regulatory Accounting Guideline 4.03, whereas business activities and indirect costs are allocated on an activity basis using quantitative measures such as headcount and other methods reflecting consumption of service.

**Amounts given to charitable trusts assisting customers**

Amounts given to charitable trusts assisting customers are expensed in the profit and loss account on an accruals basis.

**Appointed and non-appointed activities**

The company has used the guidance in Ofwat's Regulatory Accounting Guideline 3.06 in determining which of its activities are appointed or non-appointed. In summary, the appointed business is defined as the regulated activities of the Appointee, i.e. those necessary to fulfil the functions and duties of a water and sewerage undertaker. The non-appointed business encompasses those activities for which the company is not a monopoly supplier or those activities which involve the optional use of an asset owned by the appointed business. Direct costs attributable to the provision of services other than the appointed business are separately allocated and identified as non-appointed. Indirect costs, relating to non-appointed activities, are allocated based on activities undertaken during the year.

**Revenue recognition**

The statutory accounting policy is to recognise revenue where it is probable that an economic benefit associated with the transaction will flow to the company.

The company has not recognised revenue in the statutory accounts where it does not consider it probable that it will receive payment. In the regulatory accounts, revenue is recognised in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name.

A description of the revenue recognition policy adopted by the company in the regulatory accounts for different types of customers is as follows:

*'Unoccupied' properties*

Properties are deemed to be unoccupied where the company has completed the property management process and has not identified the property as occupied. No revenue is recognised in the statutory or regulatory accounts for unoccupied properties.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 1. Accounting policies (continued)

### Revenue recognition (continued)

*'Unoccupied' properties (continued)*
If consumption on a meter at an unoccupied property is noted, the company will visit the property to establish if it is occupied and attempt to obtain the customer's details. The property will remain recorded as an empty property until this process is complete unless consumption is above a predefined level in which case it will be recorded and reported as occupied. If the customer's details are obtained these are added to the billing system and the property will be recorded and reported as occupied.

*'Occupied' properties*
Properties are deemed to be 'occupied' where the company has completed its property management process and this has resulted in customer details being obtained or where consumption above a predefined threshold has been recorded on the meter of a property. Revenue is recognised in full in the regulatory accounts regardless of the customer's payment history or whether the company has the occupier's name.

As an example, consideration is given to whether the property is furnished or unfurnished. The company's approach to furnished and unfurnished properties is detailed in its charges scheme for 2010/11 in section 2.1 'Liability for Charges'. Charges will be made wherever premises are occupied or furnished. Where a customer's property is disconnected, water and foul sewerage charges will no longer be made for that property but charges for surface water and highways drainage will be made.

*'The occupier' premises*
The company continues to bill every property that is deemed to be occupied even if the company does not know the name of the occupier.

Revenue from 'the occupier' premises is not recognised in the statutory accounts until the related cash is received. However, within the regulatory accounts it is recognised in full at the date of invoicing, regardless of the customer payment history.

In cases where the company receives cash payments from customers living at properties where records suggest the property is empty, the company will review records at the cash processing office to try to obtain occupier details. If UUW does not obtain occupier details from the cash processing office UUW will further review its systems and available external data. If no further information can be found the account is billed in the name of the 'the occupier'.

*Revenue from 'charges on income'*
Where the company raises charges in respect of customers' failure to make timely payments, these charges are offset against the costs relating to these charges and not reported as revenue.

*Recognition of new properties*
The company installs meters at all new properties. New properties are recorded on the billing system once a connection is made. The property is deemed to be unoccupied until occupancy is established via the property management process, or via other means, such as the customer making contact with the company.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 2. Analysis of turnover and operating (expense)/income of the appointed business

| | Water supply £m | Sewerage services £m | 2012 Appointed business £m | Water supply £m | Sewerage services £m | 2011 Appointed business £m |
|---|---|---|---|---|---|---|
| **Turnover** | | | | | | |
| Unmeasured | 381.2 | 395.5 | 776.7 | 366.5 | 393.0 | 759.5 |
| Measured | 269.0 | 372.4 | 641.4 | 257.3 | 359.1 | 616.4 |
| Trade effluent | - | 19.6 | 19.6 | - | 20.6 | 20.6 |
| Large user and special agreement | 51.7 | 49.2 | 100.9 | 50.1 | 45.7 | 95.8 |
| Revenue grants | 0.5 | 0.2 | 0.7 | - | 0.2 | 0.2 |
| Third party services: | | | | | | |
| Non-potable large user and special agreement | 6.7 | - | 6.7 | 6.6 | - | 6.6 |
| Rechargeable works | 0.1 | 0.1 | 0.2 | - | - | - |
| Bulk supplies/intercompany payments | 0.6 | 0.1 | 0.7 | 0.8 | - | 0.8 |
| Other appointed business (third party) | 1.7 | 0.1 | 1.8 | 1.8 | 0.1 | 1.9 |
| Third party services – sub total | 9.1 | 0.3 | 9.4 | 9.2 | 0.1 | 9.3 |
| Other sources | 1.6 | 3.0 | 4.6 | 2.8 | 2.0 | 4.8 |
| **Total turnover** | 713.1 | 840.2 | 1,553.3 | 685.9 | 820.7 | 1,506.6 |
| **Operating (expense)/income** | | | | | | |
| Current cost loss on disposal of fixed assets | (2.4) | (6.2) | (8.6) | (0.9) | (3.1) | (4.0) |
| **Total operating (expense)/income** | (2.4) | (6.2) | (8.6) | (0.9) | (3.1) | (4.0) |
| **Working capital adjustment** | 0.9 | 1.1 | 2.0 | 0.7 | 0.8 | 1.5 |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 3. Current cost operating costs

For the year ended 31 March 2012:

Current cost operating cost accounting separation tables have been included for March 2012 in order to comply with the requirements of Information Notice 12/01.

**Service analysis – Water**

| | Water resources | Raw water distribution | Water treatment | Treated water distribution | Water service Total |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| **Direct costs** | | | | | |
| Employment costs | 2.9 | 0.6 | 8.3 | 11.2 | 23.0 |
| Power | 1.4 | 2.0 | 7.2 | 7.3 | 17.9 |
| Hired and contracted services | 2.4 | 0.9 | 3.6 | 15.4 | 22.3 |
| Materials and consumables | 0.1 | 0.2 | 11.5 | 1.8 | 13.6 |
| Service charges | 18.5 | - | 0.2 | - | 18.7 |
| Bulk supply imports | 1.4 | - | - | - | 1.4 |
| Other direct costs | - | - | 0.1 | 1.5 | 1.6 |
| **Total direct costs** | 26.7 | 3.7 | 30.9 | 37.2 | 98.5 |
| **Operating expenditure** | | | | | |
| General and support expenditure | 7.5 | 1.1 | 10.0 | 16.1 | 34.7 |
| Scientific services | 1.8 | 0.3 | 2.2 | 2.8 | 7.1 |
| Other business activities | 0.4 | 0.1 | 0.5 | 0.7 | 1.7 |
| Total business activities | 2.2 | 0.4 | 2.7 | 3.5 | 8.8 |
| Local Authority rates | 14.5 | 4.0 | 5.7 | 29.0 | 53.2 |
| Exceptional items | 0.7 | 0.1 | 0.8 | 1.0 | 2.6 |
| Total opex less third party services | 51.6 | 9.3 | 50.1 | 86.8 | 197.8 |
| Third party services – opex | 1.1 | 0.8 | 0.2 | 0.9 | 3.0 |
| Total operating expenditure | 52.7 | 10.1 | 50.3 | 87.7 | 200.8 |
| **Reactive and planned maintenance (including opex)** | | | | | |
| Reactive and planned maintenance infrastructure | 0.8 | 1.2 | - | 11.1 | 13.1 |
| Reactive and planned maintenance non-infrastructure | - | - | 7.6 | 0.7 | 8.3 |
| **Capital maintenance** | | | | | |
| Infrastructure renewals charge (excluding third party services) | 16.6 | 0.4 | - | 55.6 | 72.6 |
| Current cost depreciation | 10.5 | 2.0 | 57.2 | 55.3 | 125.0 |
| Amortisation of deferred credits | (0.6) | - | (0.8) | (3.6) | (5.0) |
| Business activities current cost depreciation | 0.4 | - | 0.5 | 1.8 | 2.7 |
| Capital maintenance excluding third party services | 26.9 | 2.4 | 56.9 | 109.1 | 195.3 |
| Third party services – current cost depreciation | 2.5 | 0.2 | - | 0.2 | 2.9 |
| Total capital maintenance | 29.4 | 2.6 | 56.9 | 109.3 | 198.2 |
| **Total operating cost** | **82.1** | **12.7** | **107.2** | **197.0** | **399.0** |

The depreciation charge of £0.2 million (2011: £1.7 million) on IT systems owned by United Utilities Water PLC, but recharged to other United Utilities companies, has been classified as operating expenditure in accordance with RAG 4.03.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 3. Current cost operating costs (continued)

For the year ended 31 March 2012:

**Service analysis – Retail**

| | Retail household | Retail household general & support memo | Retail non-household | Retail non-household general & support memo | Retail services Total |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| **Direct costs** | | | | | |
| Billing | 9.9 | 1.2 | 1.8 | 0.2 | 11.7 |
| Payment handling, remittance and cash-handling | 0.6 | - | 0.1 | - | 0.7 |
| Debt management | 11.9 | 1.6 | 2.9 | 0.4 | 14.8 |
| Doubtful debts | 63.1 | - | 4.4 | - | 67.5 |
| Charitable trust donation | 5.0 | - | - | - | 5.0 |
| Vulnerable customer schemes | 0.1 | - | - | - | 0.1 |
| Non network customer enquiries and complaints | 12.5 | 4.0 | 2.1 | 0.2 | 14.6 |
| Meter reading | 6.0 | - | 2.1 | - | 8.1 |
| Meter maintenance / installation non capex | 0.2 | 0.3 | - | 0.1 | 0.2 |
| Network customer enquiries and complaints | 4.3 | 2.5 | 0.3 | 0.1 | 4.6 |
| Disconnections | - | - | 0.5 | - | 0.5 |
| Demand side water efficiency initiatives | 0.6 | - | 0.2 | - | 0.8 |
| Services to developers | - | - | - | 0.6 | - |
| Support for trade effluent compliance | - | - | 1.7 | 0.7 | 1.7 |
| Customer side leaks | 0.8 | - | - | - | 0.8 |
| **Total direct costs** | 115.0 | 9.6 | 16.1 | 2.3 | 131.1 |
| **Operating expenditure** | | | | | |
| General and support expenditure | 9.6 | - | 2.3 | - | 11.9 |
| Scientific services | - | - | 0.7 | - | 0.7 |
| Other business activities | 1.3 | - | 0.3 | - | 1.6 |
| Total business activities | 1.3 | - | 1.0 | - | 2.3 |
| Local Authority rates | 0.9 | - | 0.3 | - | 1.2 |
| Exceptional items | 9.7 | - | 7.9 | - | 17.6 |
| Total opex less third party services | 136.5 | 9.6 | 27.6 | 2.3 | 164.1 |
| Third party services | - | - | - | - | - |
| Total operating expenditure | 136.5 | 9.6 | 27.6 | 2.3 | 164.1 |
| **Capital maintenance** | | | | | |
| Current cost depreciation | 25.0 | - | 3.6 | - | 28.6 |
| Amortisation of deferred credits | (0.3) | - | (0.1) | - | (0.4) |
| Total capital maintenance | 24.7 | - | 3.5 | - | 28.2 |
| **Total operating cost** | **161.2** | **9.6** | **31.1** | **2.3** | **192.3** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 3. Current cost operating costs (continued)

For the year ended 31 March 2012:

**Service analysis – Sewerage**

| | Sewage collection | Sewage treatment | Sludge treatment | Sludge disposal | Sewerage service Total | **Total** |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | **£m** |
| **Direct costs** | | | | | | |
| Employment costs | 8.0 | 11.2 | 5.6 | 3.4 | 28.2 | |
| Power | 2.7 | 18.6 | 0.1 | 2.3 | 23.7 | |
| Hired and contracted services | 18.0 | 3.7 | 1.8 | 8.3 | 31.8 | |
| Materials and consumables | 1.3 | 6.1 | 2.7 | 2.5 | 12.6 | |
| Service charges | 1.6 | 4.5 | 0.3 | - | 6.4 | |
| Other direct costs | 1.0 | 0.1 | 0.1 | - | 1.2 | |
| **Total direct costs** | 32.6 | 44.2 | 10.6 | 16.5 | 103.9 | **333.5** |
| **Operating expenditure** | | | | | | |
| General and support expenditure | 13.1 | 21.5 | 8.5 | 9.0 | 52.1 | |
| Scientific services | 0.6 | 1.0 | 0.3 | 0.4 | 2.3 | |
| Other business activities | 0.4 | 0.7 | 0.2 | 0.3 | 1.6 | |
| Total business activities | 1.0 | 1.7 | 0.5 | 0.7 | 3.9 | |
| Local Authority rates | 3.0 | 16.2 | 4.5 | - | 23.7 | |
| Exceptional items | 0.7 | 1.2 | 0.3 | 0.4 | 2.6 | |
| Total opex less third party services | 50.4 | 84.8 | 24.4 | 26.6 | 186.2 | |
| Third party services – opex | - | - | - | - | - | |
| Total operating expenditure | 50.4 | 84.8 | 24.4 | 26.6 | 186.2 | **551.1** |
| **Reactive and planned maintenance (including opex)** | | | | | | |
| Reactive and planned maintenance infrastructure | 22.8 | - | - | - | 22.8 | |
| Reactive and planned maintenance non-infrastructure | 5.3 | 15.6 | 1.8 | 2.8 | 25.5 | |
| **Capital maintenance** | | | | | | |
| Infrastructure renewals charge (excluding third party services) | 67.5 | 1.5 | - | - | 69.0 | |
| Current cost depreciation | 34.3 | 151.3 | 41.9 | 1.4 | 228.9 | |
| Amortisation of deferred credits | (3.6) | (0.4) | - | - | (4.0) | |
| Business activities current cost depreciation | 1.1 | 1.9 | 0.6 | - | 3.6 | |
| Total capital maintenance | 99.3 | 154.3 | 42.5 | 1.4 | 297.5 | **523.9** |
| **Total operating cost** | **149.7** | **239.1** | **66.9** | **28.0** | **483.7** | **1,075.0** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 3. Current cost operating costs (continued)

For the year ended 31 March 2011:

| **Service analysis** | | | Water supply | | | Sewerage service | | |
|---|---|---|---|---|---|---|---|---|
| | Resources and treatment £m | Distribution £m | Water supply subtotal £m | Sewerage £m | Sewage treatment £m | Sludge treatment and disposal £m | Sewerage service subtotal £m | Total appointed business £m |
| **Direct costs** | | | | | | | | |
| Employment costs | 10.6 | 10.5 | 21.1 | 5.6 | 10.1 | 8.7 | 24.4 | 45.5 |
| Power | 10.3 | 9.2 | 19.5 | 2.0 | 14.1 | 5.7 | 21.8 | 41.3 |
| Hired and contracted services | 4.0 | 14.9 | 18.9 | 12.8 | 3.9 | 9.1 | 25.8 | 44.7 |
| Materials and consumables | 11.7 | 0.5 | 12.2 | 1.3 | 6.1 | 4.8 | 12.2 | 24.4 |
| Service charges | 17.6 | - | 17.6 | 1.9 | 3.9 | - | 5.8 | 23.4 |
| Bulk supply imports | 1.3 | - | 1.3 | - | - | - | - | 1.3 |
| Other direct costs | 0.8 | 2.6 | 3.4 | 0.3 | - | 0.1 | 0.4 | 3.8 |
| **Total direct costs** | 56.3 | 37.7 | 94.0 | 23.9 | 38.1 | 28.4 | 90.4 | 184.4 |
| General and support expenditure | 24.5 | 22.2 | 46.7 | 11.9 | 38.2 | 19.0 | 69.1 | 115.8 |
| Total functional expenditure | 80.8 | 59.9 | 140.7 | 35.8 | 76.3 | 47.4 | 159.5 | 300.2 |
| **Business activities** | | | | | | | | |
| Customer services | | | 30.2 | | | | 30.4 | 60.6 |
| Scientific services | | | 5.7 | | | | 4.2 | 9.9 |
| Other business activities | | | 3.1 | | | | 3.1 | 6.2 |
| Total business activities | | | 39.0 | | | | 37.7 | 76.7 |
| Local authority rates | | | 45.1 | | | | 21.9 | 67.0 |
| Doubtful debts | | | 28.7 | | | | 34.3 | 63.0 |
| Exceptional items | | | 6.3 | | | | 5.6 | 11.9 |
| Total operating expenditure less third party services | | | 259.8 | | | | 259.0 | 518.8 |
| Third party services - operating expenditure | | | 5.0 | | | | - | 5.0 |
| Total operating expenditure | | | 264.8 | | | | 259.0 | 523.8 |
| **Capital maintenance** | | | | | | | | |
| Infrastructure renewals charge | 16.7 | 51.7 | 68.4 | 71.9 | - | - | 71.9 | 140.3 |
| Current cost depreciation | | | | | | | | |
| - service activities | 88.5 | 72.2 | 160.7 | 34.7 | 146.3 | 43.8 | 224.8 | 385.5 |
| - business activities | | | 3.5 | | | | 4.5 | 8.0 |
| Amortisation of grants | | | (5.2) | | | | (3.7) | (8.9) |
| Capital maintenance excluding third party services | | | 227.4 | | | | 297.5 | 524.9 |
| Third party services | | | | | | | | |
| - current cost depreciation | | | 3.0 | | | | - | 3.0 |
| Total capital maintenance | | | 230.4 | | | | 297.5 | 527.9 |
| **Total operating costs** | | | 495.2 | | | | 556.5 | 1,051.7 |
| **CCA (MEA) values:** | | | | | | | | |
| Service activities | 7,696.8 | 9,915.4 | 17,612.2 | 34,843.2 | 2,772.4 | 722.9 | 38,338.5 | 55,950.7 |
| Business activities | | | 14.8 | | | | 18.6 | 33.4 |
| | | | 17,627.0 | | | | 38,357.1 | 55,984.1 |
| Services for the third parties | | | 53.4 | | | | - | 53.4 |
| **Total CCA (MEA) values** | | | 17,680.4 | | | | 38,357.1 | 56,037.5 |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 4. Other income

| | 2012 £m | 2011 £m |
|---|---|---|
| Rents receivable | - | 1.0 |

Rental income has been classified as non-appointed this year, in previous years it has been shown as appointed.

## 5. Current cost analysis of fixed assets by asset type

Current cost fixed asset accounting separation tables have been included for March 2012 in order to comply with the requirements of Information Notice 12/01.

| **Analysis of fixed assets by business unit; Water Service** | **Water Resources** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 5,026.0 | 445.4 | 18.7 | **5,490.1** |
| Reclassification adjustment | (16.2) | 7.6 | (4.3) | **(12.9)** |
| RPI adjustment | 179.5 | 15.7 | 0.6 | **195.8** |
| Disposals | - | (7.4) | (2.0) | **(9.4)** |
| Additions | 1.0 | 9.1 | 1.5 | **11.6** |
| Gross replacement cost at 31 March 2012 | 5,190.3 | 470.4 | 14.5 | **5,675.2** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 211.1 | 14.9 | **226.0** |
| Reclassification adjustment | | (1.4) | (3.5) | **(4.9)** |
| RPI adjustment | | 7.2 | 0.5 | **7.7** |
| Disposals | | (7.2) | (1.9) | **(9.1)** |
| Charge for year | | 11.8 | 1.6 | **13.4** |
| Depreciation at 31 March 2012 | | 221.5 | 11.6 | **233.1** |
| Net book amount at 31 March 2012 | 5,190.3 | 248.9 | 2.9 | **5,442.1** |
| Net book amount at 1 April 2011 | 5,026.0 | 234.3 | 3.8 | **5,264.1** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

| **Analysis of fixed assets by business unit; Water Service** | **Raw Water Distribution** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 1,426.1 | 78.7 | 3.3 | **1,508.1** |
| Reclassification adjustment | - | (0.9) | (1.2) | **(2.1)** |
| RPI adjustment | 50.9 | 2.8 | 0.1 | **53.8** |
| Disposals | - | (1.0) | (0.5) | **(1.5)** |
| Additions | 0.2 | 0.4 | 0.3 | **0.9** |
| Gross replacement cost at 31 March 2012 | 1,477.2 | 80.0 | 2.0 | **1,559.2** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 43.0 | 2.4 | **45.4** |
| Reclassification adjustment | | (0.4) | (0.8) | **(1.2)** |
| RPI adjustment | | 1.5 | 0.1 | **1.6** |
| Disposals | | (1.0) | (0.4) | **(1.4)** |
| Charge for year | | 2.0 | 0.2 | **2.2** |
| Depreciation at 31 March 2012 | | 45.1 | 1.5 | **46.6** |
| Net book amount at 31 March 2012 | 1,477.2 | 34.9 | 0.5 | **1,512.6** |
| Net book amount at 1 April 2011 | 1,426.1 | 35.7 | 0.9 | **1,462.7** |

| **Analysis of fixed assets by business unit; Water Service** | **Water Treatment** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 5.7 | 2,078.4 | 50.0 | **2,134.1** |
| Reclassification adjustment | (0.9) | (1.1) | (1.2) | **(3.2)** |
| RPI adjustment | 0.2 | 73.3 | 1.5 | **75.0** |
| Disposals | - | (25.5) | (8.3) | **(33.8)** |
| Additions | 3.4 | 39.1 | 4.2 | **46.7** |
| Gross replacement cost at 31 March 2012 | 8.4 | 2,164.2 | 46.2 | **2,218.8** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 1,088.7 | 33.8 | **1,122.5** |
| Reclassification adjustment | | (2.3) | 0.2 | **(2.1)** |
| RPI adjustment | | 38.0 | 0.9 | **38.9** |
| Disposals | | (24.7) | (7.9) | **(32.6)** |
| Charge for year | | 53.2 | 4.6 | **57.8** |
| Depreciation at 31 March 2012 | | 1,152.9 | 31.6 | **1,184.5** |
| Net book amount at 31 March 2012 | 8.4 | 1,011.3 | 14.6 | **1,034.3** |
| Net book amount at 1 April 2011 | 5.7 | 989.7 | 16.2 | **1,011.6** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

| **Analysis of fixed assets by business unit; Water Service** | **Treated Water Distribution** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 8,802.3 | 2,039.2 | 96.6 | **10,938.1** |
| Reclassification adjustment | (2.1) | 16.7 | 20.6 | **35.2** |
| RPI adjustment | 314.2 | 72.3 | 3.1 | **389.6** |
| Disposals | - | (13.9) | (10.9) | **(24.8)** |
| Additions | 63.8 | 34.6 | 7.0 | **105.4** |
| Gross replacement cost at 31 March 2012 | 9,178.2 | 2,148.9 | 116.4 | **11,443.5** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 1,041.6 | 64.9 | **1,106.5** |
| Reclassification adjustment | | 3.5 | 12.0 | **15.5** |
| RPI adjustment | | 36.6 | 2.0 | **38.6** |
| Disposals | | (13.8) | (9.9) | **(23.7)** |
| Charge for year | | 43.6 | 13.7 | **57.3** |
| Depreciation at 31 March 2012 | | 1,111.5 | 82.7 | **1,194.2** |
| Net book amount at 31 March 2012 | 9,178.2 | 1,037.4 | 33.7 | **10,249.3** |
| Net book amount at 1 April 2011 | 8,802.3 | 997.6 | 31.7 | **9,831.6** |

| **Analysis of fixed assets by business unit; Water Service** | **Total** |
|---|---|
| **Gross replacement cost** | |
| Gross replacement cost at 1 April 2011 | **20,070.4** |
| Reclassification adjustment | **17.0** |
| RPI adjustment | **714.2** |
| Disposals | **(69.5)** |
| Additions | **164.6** |
| Gross replacement cost at 31 March 2012 | **20,896.7** |
| **Depreciation** | |
| Depreciation at 1 April 2011 | **2,500.4** |
| Reclassification adjustment | **7.3** |
| RPI adjustment | **86.8** |
| Disposals | **(66.8)** |
| Charge for year | **130.7** |
| Depreciation at 31 March 2012 | **2,658.4** |
| Net book amount at 31 March 2012 | **18,238.3** |
| Net book amount at 1 April 2011 | **17,570.0** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

**Analysis of fixed assets by business unit; Sewerage Service**

| | Sewage Collection | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 34,316.0 | 940.5 | 71.9 | **35,328.4** |
| Reclassification adjustment | (19.4) | 13.8 | (2.5) | **(8.1)** |
| RPI adjustment | 1,225.0 | 33.2 | 2.2 | **1,260.4** |
| Disposals | (0.5) | (11.2) | (6.8) | **(18.5)** |
| Additions[1] | 17,994.6 | 45.7 | 6.8 | **18,047.1** |
| Gross replacement cost at 31 March 2012 | 53,515.7 | 1,022.0 | 71.6 | **54,609.3** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 470.8 | 49.4 | **520.2** |
| Reclassification adjustment | | (2.6) | (2.0) | **(4.6)** |
| RPI adjustment | | 16.5 | 1.5 | **18.0** |
| Disposals | | (11.1) | (6.2) | **(17.3)** |
| Charge for year | | 27.4 | 8.0 | **35.4** |
| Depreciation at 31 March 2012 | | 501.0 | 50.7 | **551.7** |
| Net book amount at 31 March 2012 | 53,515.7 | 521.0 | 20.9 | **54,057.6** |
| Net book amount at 1 April 2011 | 34,316.0 | 469.7 | 22.5 | **34,808.2** |

**Analysis of fixed assets by business unit; Sewerage Service**

| | Sewage Treatment | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 277.9 | 5,061.4 | 89.8 | **5,429.1** |
| Reclassification adjustment | (1.4) | 4.7 | 1.3 | **4.6** |
| RPI adjustment | 9.9 | 178.9 | 2.7 | **191.5** |
| Disposals | - | (49.6) | (15.3) | **(64.9)** |
| Additions | 0.8 | 130.9 | 13.8 | **145.5** |
| Gross replacement cost at 31 March 2012 | 287.2 | 5,326.3 | 92.3 | **5,705.8** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 2,587.1 | 63.4 | **2,650.5** |
| Reclassification adjustment | | 5.4 | 3.4 | **8.8** |
| RPI adjustment | | 90.7 | 1.7 | **92.4** |
| Disposals | | (45.9) | (14.4) | **(60.3)** |
| Charge for year | | 143.6 | 9.6 | **153.2** |
| Depreciation at 31 March 2012 | | 2,780.9 | 63.7 | **2,844.6** |
| Net book amount at 31 March 2012 | 287.2 | 2,545.4 | 28.6 | **2,861.2** |
| Net book amount at 1 April 2011 | 277.9 | 2,474.3 | 26.4 | **2,778.6** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

**Analysis of fixed assets by business unit; Sewerage Service**

| | Sludge Treatment | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | 34.5 | 1,397.2 | 20.8 | **1,452.5** |
| Reclassification adjustment | - | 11.8 | (0.9) | **10.9** |
| RPI adjustment | 1.2 | 49.6 | 0.6 | **51.4** |
| Disposals | - | (7.8) | (3.0) | **(10.8)** |
| Additions | - | 35.9 | 2.9 | **38.8** |
| Gross replacement cost at 31 March 2012 | 35.7 | 1,486.7 | 20.4 | **1,542.8** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 723.2 | 16.1 | **739.3** |
| Reclassification adjustment | | 3.0 | (0.4) | **2.6** |
| RPI adjustment | | 25.6 | 0.4 | **26.0** |
| Disposals | | (7.2) | (2.5) | **(9.7)** |
| Charge for year | | 40.3 | 2.2 | **42.5** |
| Depreciation at 31 March 2012 | | 784.9 | 15.8 | **800.7** |
| Net book amount at 31 March 2012 | 35.7 | 701.8 | 4.6 | **742.1** |
| Net book amount at 1 April 2011 | 34.5 | 674.0 | 4.7 | **713.2** |

**Analysis of fixed assets by business unit; Sewerage Service**

| | Sludge Disposal | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | | 10.1 | 13.1 | **23.2** |
| Reclassification adjustment | | (2.2) | (2.5) | **(4.7)** |
| RPI adjustment | | 0.3 | 0.4 | **0.7** |
| Disposals | | (0.3) | (3.3) | **(3.6)** |
| Additions | | 1.9 | 2.3 | **4.2** |
| Gross replacement cost at 31 March 2012 | | 9.8 | 10.0 | **19.8** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 1.3 | 9.4 | **10.7** |
| Reclassification adjustment | | (1.7) | (1.9) | **(3.6)** |
| RPI adjustment | | - | 0.3 | **0.3** |
| Disposals | | (0.3) | (3.3) | **(3.6)** |
| Charge for year | | 0.3 | 1.1 | **1.4** |
| Depreciation at 31 March 2012 | | (0.4) | 5.6 | **5.2** |
| Net book amount at 31 March 2012 | | 10.2 | 4.4 | **14.6** |
| Net book amount at 1 April 2011 | | 8.8 | 3.7 | **12.5** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

**Analysis of fixed assets by business unit;**
**Sewerage Service**

| | **Total £m** |
|---|---|
| **Gross replacement cost** | |
| Gross replacement cost at 1 April 2011 | **42,233.2** |
| Reclassification adjustment | **2.7** |
| RPI adjustment | **1,504.0** |
| Disposals | **(97.8)** |
| Additions | **18,235.6** |
| Gross replacement cost at 31 March 2012 | **61,877.7** |
| **Depreciation** | |
| Depreciation at 1 April 2011 | **3,920.7** |
| Reclassification adjustment | **3.2** |
| RPI adjustment | **136.7** |
| Disposals | **(90.9)** |
| Charge for year | **232.5** |
| Depreciation at 31 March 2012 | **4,202.2** |
| Net book amount at 31 March 2012 | **57,675.5** |
| Net book amount at 1 April 2011 | **38,312.5** |

**Analysis of fixed assets by business unit; Retail**

| | **Retail Household** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | | 269.5 | 59.2 | **328.7** |
| Reclassification adjustment | | 9.0 | (27.9) | **(18.9)** |
| RPI adjustment | | 9.2 | 1.8 | **11.0** |
| Disposals | | (11.1) | (8.8) | **(19.9)** |
| Additions | | 11.0 | 9.4 | **20.4** |
| Gross replacement cost at 31 March 2012 | | 287.6 | 33.7 | **321.3** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 159.8 | 35.9 | **195.7** |
| Reclassification adjustment | | 4.4 | (14.2) | **(9.8)** |
| RPI adjustment | | 5.3 | 1.0 | **6.3** |
| Disposals | | (10.1) | (8.8) | **(18.9)** |
| Charge for year | | 23.3 | 1.7 | **25.0** |
| Depreciation at 31 March 2012 | | 182.7 | 15.6 | **198.3** |
| Net book amount at 31 March 2012 | | 104.9 | 18.1 | **123.0** |
| Net book amount at 1 April 2011 | | 109.7 | 23.3 | **133.0** |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

| **Analysis of fixed assets by business unit; Retail** | **Retail Non-Household** | | | |
|---|---|---|---|---|
| | Infrastructure assets £m | Operational assets £m | Other tangible assets £m | **Subtotal £m** |
| **Gross replacement cost** | | | | |
| Gross replacement cost at 1 April 2011 | | 93.7 | 10.2 | **103.9** |
| Reclassification adjustment | | (1.5) | (0.2) | **(1.7)** |
| RPI adjustment | | 3.3 | 0.3 | **3.6** |
| Disposals | | (1.2) | (2.9) | **(4.1)** |
| Additions | | 2.7 | 2.7 | **5.4** |
| Gross replacement cost at 31 March 2012 | | 97.0 | 10.1 | **107.1** |
| **Depreciation** | | | | |
| Depreciation at 1 April 2011 | | 75.4 | 6.5 | **81.9** |
| Reclassification adjustment | | (1.6) | 0.7 | **(0.9)** |
| RPI adjustment | | 2.7 | 0.1 | **2.8** |
| Disposals | | (1.2) | (2.9) | **(4.1)** |
| Charge for year | | 3.1 | 0.6 | **3.7** |
| Depreciation at 31 March 2012 | | 78.4 | 5.0 | **83.4** |
| Net book amount at 31 March 2012 | | 18.6 | 5.1 | **23.7** |
| Net book amount at 1 April 2011 | | 18.3 | 3.7 | **22.0** |

| **Analysis of fixed assets by business unit; Retail** | **Total £m** |
|---|---|
| **Gross replacement cost** | |
| Gross replacement cost at 1 April 2011 | **432.6** |
| Reclassification adjustment | **(20.6)** |
| RPI adjustment | **14.6** |
| Disposals | **(24.0)** |
| Additions | **25.8** |
| Gross replacement cost at 31 March 2012 | **428.4** |
| **Depreciation** | |
| Depreciation at 1 April 2011 | **277.6** |
| Reclassification adjustment | **(10.7)** |
| RPI adjustment | **9.1** |
| Disposals | **(23.0)** |
| Charge for year | **28.7** |
| Depreciation at 31 March 2012 | **281.7** |
| Net book amount at 31 March 2012 | **146.7** |
| Net book amount at 1 April 2011 | **155.0** |

**Note:**

1. The ownership of, and responsibility for, certain private sewers in UUW's region were transferred to the company on 1 October 2011. To meet the requirements of RAG1.04, these assets have been included in fixed asset additions at their modern equivalent asset (MEA) cost with a corresponding credit to third party contributions. The value included is based on data from a report completed by UK Water Industry Research (UKWIR) in 2007 which estimated the length of private sewers, and the number of chambers and other associated assets, to be adopted in each region in England and Wales as part of the private sewers transfer. UKWIR used average lengths of each type of drain or sewer, with different lengths applied depending on the age and type of property. To calculate the MEA cost at October 2011, the housing stock for the UUW region was updated using published local government data and valued at current construction unit costs for similar replacement activities on public sewers. This valuation will be reviewed as further data becomes available.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 6. Regulatory capital value (RCV)

| | £m |
|---|---|
| Closing RCV at 31 March 2011 | 8,179.9 |
| RCV inflation adjustment | 292.0 |
| Opening RCV at 1 April 2011 in March 2012 prices | 8,471.9 |
| Capital expenditure (excluding infrastructure renewals expenditure) | 648.7 |
| Infrastructure renewals expenditure | 186.6 |
| Infrastructure renewals charge | (151.5) |
| Grants and contributions | (19.2) |
| Current cost depreciation | (393.6) |
| AMP 4 outperformance of regulatory assumptions | (18.6) |
| Closing RCV at 31 March 2012 | 8,724.3 |
| Average RCV (2011/12 year average prices) | 8,474.6 |

The figures quoted reflect those used by Ofwat at the 2009 Periodic Review to set prices for the period 2010-2015 as confirmed by Ofwat in RD04/10. All costs have been indexed to March 2012 prices (RPI index) except for the average RCV, which is shown at year average prices in accordance with Ofwat's convention.

Differences between the figures shown above and actual costs/income will not affect price limits in the current period. Variation in capital expenditure from those assumed at the 2009 price review will be taken into account in the calculation at the next price review through operation of the Capital Incentive Scheme.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 7. Working capital

| | 2012 £m | 2011 £m |
|---|---|---|
| Stocks | 5.0 | 4.6 |
| Trade debtors (see below) | 190.8 | 186.2 |
| Measured income accrual | 123.0 | 112.4 |
| Prepayments and other debtors | 20.1 | 11.7 |
| Trade creditors | (39.3) | (58.7) |
| Deferred income – customer advance receipts | (136.6) | (120.8) |
| Short-term capital creditors | (119.2) | (133.8) |
| Accruals and other creditors | (121.3) | (57.9) |
| **Total working capital** | (77.5) | (56.3) |

Further details in connection with trade debtors are set out below:

| | 2012 £m | 2011 £m |
|---|---|---|
| Measured household | 34.4 | 32.6 |
| Unmeasured household | 93.1 | 94.1 |
| Measured non-household | 34.5 | 37.9 |
| Unmeasured non-household | 9.9 | 11.0 |
| Other | 18.9 | 10.6 |
| **Trade debtors** | 190.8 | 186.2 |

## 8. Movement on current cost reserve

| | 2012 £m | 2011 £m |
|---|---|---|
| At the start of the year | 48,720.8 | 46,077.6 |
| RPI adjustments: | | |
| Fixed assets | 2,000.2 | 2,836.9 |
| Working capital | (2.0) | (1.5) |
| Financing | (111.6) | (167.3) |
| Grants and third party contributions | (19.8) | (24.9) |
| At the end of the year | 50,587.6 | 48,720.8 |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 9. Information in respect of transactions with any other business or activity of the appointee or any associated company

To the best of their knowledge, the directors of the company declare that all appropriate transactions with associated companies have been disclosed and material transactions with associated companies are at arm's length and no cross-subsidy has occurred. The materiality level of transactions used for reporting is 0.5% of turnover.

**Borrowings and sums lent**

The following loans from associated companies existed at 31 March 2012:

| | £m | Interest rate | Repayment date |
|---|---|---|---|
| United Utilities PLC: $400.0 million bond | 282.9 | 6.875% | August 2028 |
| United Utilities Finance Holdings Limited: £205.5 million loan | 205.5 | 0.745%+LIBOR | July 2034 |
| United Utilities PLC: Loan facility of £750.0 million | 324.8 | 0.05%+LIBOR | On at least 18 months notice |
| United Utilities PLC: overdraft facility | 20.7 | 0.5%+LIBOR | On demand |
| United Utilities North West PLC: preference shares | 130.0 | 7.0% | October 2099 |

The following loans to associated companies existed at 31 March 2012:

| | £m | Interest rate | Repayment date |
|---|---|---|---|
| United Utilities PLC: £40.0m loan | 40.0 | 0.5%+LIBOR | On demand |

**Financial instruments**

The following financial instruments with associated companies existed at 31 March 2012:

| | Fair value £m | Interest rate payable £m | Interest rate receivable £m | Maturity date £m |
|---|---|---|---|---|
| United Utilities PLC - £400m interest rate swap | 6.7 | 1.84% | LIBOR | March 2015 |

**Dividends paid to associated undertakings**

During the year, interim dividends payable to United Utilities North West PLC totalled £342.0 million (2011: £262.2 million). No final dividend has been recommended for 2011/12 (2011: £nil).

**Transfer of assets by or to the appointee**

There were no transfers of assets or liabilities by or to the company in excess of the materiality limit in the current or prior year.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 9. Information in respect of transactions with any other business or activity of the appointee or any associated company (continued)

**Services supplied to the company by associated companies:**

| Nature of transaction | Company | Terms of supply | March 2012 Total value of goods, works or services £m |
|---|---|---|---|
| Functions support | United Utilities Group PLC, United Utilities PLC | Recharge of costs | 29.3 |
| Accommodation | United Utilities Property Services Ltd | Contract price | 0.8 |

**Services supplied by the company to associated companies:**

| Nature of transaction | Company | Terms of supply | March 2012 Total value of goods, works or services £m |
|---|---|---|---|
| Salaries | Various | Recharge of costs | 3.0 |
| Wastewater treatment services | Unites Utilities Water PLC (non appointed) | Contract price | 1.3 |
| Accommodation | United Utilities Property Services Ltd | Recharge of costs | 1.3 |
| Functions support | United Utilities Property Services Ltd | Recharge of costs | 0.4 |
| Property Searches | United Utilities Water PLC (non appointed) | Contract price | 0.8 |
| Use of systems | United Utilities PLC | Recharge of costs | 0.2 |

Following the disposal in 2010/11 of the majority of United Utilities group's non-regulated businesses, the services provided by United Utilities PLC Functions' employees (including ICT, HR, Finance, Corporate Affairs and General Counsel, previously described as Support Services) now predominantly support UUW. These costs continued to be incurred in United Utilities PLC throughout 2011/12 and recharged to United Utilities Water PLC. Other Functions' operating costs have generally been incurred directly by UUW although some recharges have been required.

Costs relating to non-regulated activities have either been charged directly to the appropriate non-regulated cost centres or recharged to the non-regulated entities as appropriate.

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 10. Interest rate risk profile

| | Fixed rate £m | Floating rate £m | Index-linked £m | 2012 Total £m |
|---|---|---|---|---|
| **Maturity profile** | | | | |
| Due within one year | 41.3 | 20.7 | - | 62.0 |
| Due between one and two years | 22.9 | 324.4 | - | 347.3 |
| Due between two and five years | 430.9 | - | 240.5 | 671.4 |
| Due between five and 20 years | 1,840.3 | 38.3 | 843.1 | 2,721.7 |
| Due after more than 20 years | 258.7 | 205.5 | 1,583.4 | 2,047.6 |
| Borrowings (excluding preference shares) | 2,594.1 | 588.9 | 2,667.0 | 5,850.0 |
| Preference share capital | | | | 130.0 |
| Total borrowings | | | | 5,980.0 |
| Bank overdraft | | | | 8.5 |
| Short-term deposits (intercompany loans) | | | | (40.0) |
| Net debt excluding derivatives | | | | 5,948.5 |

| | Fixed rate £m | Floating rate £m | Index-linked £m | 2011 Total £m |
|---|---|---|---|---|
| **Maturity profile** | | | | |
| Due within one year | 0.3 | 73.3 | - | 73.6 |
| Due between one and two years | 0.3 | 374.7 | - | 375.0 |
| Due between two and five years | 454.4 | - | - | 454.4 |
| Due between five and 20 years | 1,679.8 | 37.8 | 699.3 | 2,416.9 |
| Due after more than 20 years | 223.5 | 205.5 | 1,516.4 | 1,945.4 |
| Borrowings (excluding preference shares) | 2,358.3 | 691.3 | 2,215.7 | 5,265.3 |
| Preference share capital | | | | 130.0 |
| Total borrowings | | | | 5,395.3 |
| Bank overdraft | | | | 7.4 |
| Cash at bank and in hand | | | | (0.3) |
| Short-term deposits (intercompany loans) | | | | (40.0) |
| Current asset investments | | | | (1.6) |
| Net debt excluding derivatives | | | | 5,360.8 |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 11. Differences between historical cost regulatory accounts and statutory accounts

| | Statutory (UK GAAP) | Regulatory Total business | Difference | Explanation of differences |
|---|---|---|---|---|
| | £m | £m | £m | |
| **Profit and loss account** | | | | |
| Operating profit including other income | 596.7 | 596.8 | 0.1 | During 2011/12, £12.6 million (2011: £11.7 million), including £10.0 million (2011: £10.3 million) relating to the water mains cleaning programme and £1.9 million (2011: £1.1 million) relating to DG5 flooding programme, has been capitalised in the statutory accounts based on the company's interpretation of FRS 15 'Tangible Fixed Assets' and the company has used a five-year period to calculate the infrastructure renewals charge. In the regulatory accounts, expenditure on the water mains cleaning programme and the DG5 flooding programme has been classified as infrastructure renewals expenditure and a 15 year period has been used to calculate the infrastructure renewals charge, based on the company's interpretation of RAG 2.03. These two items have increased the infrastructure renewals charge in the regulatory accounts by £2.5 million (2011: £1.2 million). A debit adjustment of £2.1 million (2011: £0.8 million) has also been made to the deferred taxation charge as a result of this treatment.<br><br>In the regulatory accounts, revenue is recognised in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name. The company has not recognised revenue in the statutory accounts where it does not consider it probable that it will receive payment, in accordance with FRS 5 'Reporting the Substance of Transactions' Application Note G. The adjustment to turnover in the regulatory accounts net of bad debt charge, being a net credit of £2.6 million (2011: £2.5 million) has been recorded. As a result of this treatment a credit adjustment of £1.4 million has been made to the deferred tax charge relating to prior year revenue recognised in the regulatory accounts (2011: debit £1.1 million to current tax charge). |
| Profit on ordinary activities before tax | 243.7 | 243.8 | 0.1 | |
| Taxation charge | (122.9) | (123.6) | (0.7) | |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 11. Differences between historical cost regulatory accounts and statutory accounts (continued)

| | Statutory (UK GAAP) | Regulatory Total business | Difference | Explanation of differences |
|---|---|---|---|---|
| | £m | £m | £m | |
| **Balance sheet** | | | | |
| Tangible fixed assets (net book value) | 8,324.2 | 8,254.9 | (69.3) | In the preparation of the statutory accounts, the company has followed industry practice and applied the infrastructure renewals accounting basis as set out in FRS 15 'Tangible Fixed Assets'. An infrastructure renewals accrual of £9.3 million (2011: £24.6 million) is within fixed assets in the statutory accounts. However, for the purposes of the regulatory accounts, Ofwat has requested that FRS 15 'Tangible Fixed Assets' is not applied for infrastructure renewals accounting. The regulatory accounts infrastructure renewals prepayment of £7.4 million (2011: £7.2 million) is therefore shown within current assets in the regulatory accounts. The difference between the infrastructure renewals accrual in the statutory accounts and infrastructure renewals prepayments in the regulatory accounts arises from the differences in interpretation of infrastructure renewals accounting policies as explained in the profit and loss differences summary on page 111.<br><br>The regulatory accounts fixed assets include the cumulative value of the statutory to regulatory adjustments, such as the water mains cleaning programme and the DG5 flooding programme, total expenditure of £78.6 million (2011: £91.2 million). |
| Short-term deposits | - | 40.0 | 40.0 | Short-term deposits in the regulatory balance sheet include loans to group companies. These balances are classified in debtors falling due within one year within the statutory balance sheet. |
| Debtors | 814.3 | 840.4 | 26.1 | As detailed above, £40.0 million of loans to group companies are classified in debtors falling due within one year within the statutory balance sheet but as short-term deposits in the regulatory balance sheet.<br><br>As previously explained, the company has not recognised revenue in the statutory accounts where it does not consider it probable that it will receive payment. In the regulatory accounts, revenue is recognised in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name. The impact of this adjustment is an increase in trade debtors on the regulatory balance sheet of £6.2 million (2011: £3.8 million).<br><br>An amount of £59.9 million (2011: £55.7 million) relating to measured customers who have credit balances arising from a direct debit plan existed at 31 March 2012. In line with the reporting requirements of Regulatory Reporting, these balances have been classified within creditors falling due within one year in the regulatory accounts. However, these balances are classified in debtors falling due within one year within the statutory accounts. |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

| | Statutory (UK GAAP) | Regulatory Total business | Difference | Explanation of differences |
|---|---|---|---|---|
| | £m | £m | £m | |
| Creditors: amounts falling due within one year | (649.6) | (573.1) | 76.5 | In line with the requirements of RAG 3.06, the £130.0 million (2011: £130.0 million) preference shares have been separately disclosed on the face of the regulatory balance sheet. As these shares may be redeemed by not less than 30 days' written notice served by the company or the shareholder, they have been classified within the borrowings creditor falling due within one year within the statutory accounts.<br><br>In the regulatory accounts, deferred grants are classified within provisions for liabilities and charges in line with RAG 3.06. However, these amounts are classified for statutory accounts within creditors due within one year (£6.4 million) and creditors falling due after one year (£74.3 million).<br><br>An amount of £59.9 million (2011: £55.7 million) relating to measured customers who have credit balances arising from a direct debit plan existed at 31 March 2012. In line with the reporting requirements of Regulatory Reporting, these balances have been classified within creditors falling due within one year in the regulatory accounts. However, these balances are classified in debtors falling due within one year within the statutory accounts. |
| Creditors: amounts falling due after one year | (6,040.2) | (5,965.9) | 74.3 | As detailed above, deferred grants are classified within provisions for liabilities and charges in the regulatory accounts in line with RAG 3.06 but within creditors falling due after one year in the statutory accounts. |
| Provisions for liabilities and charges (including pension liability) | (436.6) | (507.8) | (71.2) | Provisions are £80.7 million higher in the regulatory accounts due to the inclusion of deferred grants as detailed above (2011: £84.4 million).<br><br>This increase is partially offset by a lower deferred tax provision of £9.5 million (2011: £11.6 million) in the regulatory accounts due to the impact of the difference in the infrastructure renewals policy and capitalisation of the water mains cleaning programme and the DG5 flooding programme between the statutory and regulatory accounts. |
| Preference share capital | - | (130.0) | (130.0) | In line with the requirements of RAG 3.06, £130.0 million (2011: £130.0 million) of preference shares have been separately disclosed on the face of the regulatory balance sheet. As these shares may be redeemed by not less than 30 days' written notice served by the company or the shareholder, they have been classified within the borrowings creditor falling due within one year within the statutory accounts. |

# Notes to the current cost accounts (continued)

**At 31 March 2012**

## 12. Statement of directors' remuneration and standards of performance

During the year ended 31 March 2012, remuneration has been paid by the company to the directors as a result of arrangements linking directors' remuneration to levels of performance against service standards in connection with activities subject to price regulation.

For the purposes of this disclosure the company's directors can be split into two categories:

- Executive directors of UUW; and
- Non-executive directors of UUW.

The UUW executive directors participate in the United Utilities bonus scheme as documented in the UUG 2012 Annual Report and Financial Statements. The bonus scheme commences at the start of each financial year (or the date of initial appointment if later), and incentivises the achievement of specific standards of performance on a number of operational and financial measures. Through the bonus scheme, the UUW PLC executive directors can receive remuneration linked to water service standards in order to provide an incentive for them to deliver improvements in those standards.

In determining the outcome of the United Utilities bonus scheme, standards of performance were assessed by the UUG PLC Remuneration Committee to ascertain whether targets were achieved. In addition, the directors also considered relevant reports from Ofwat in assessing the achievement of standards of performance. For most measures there was a threshold level of performance which triggered a partial payment of bonus with a sliding scale providing for achievement of up to 100% of the relevant element of bonus. In 2011/12 each of the UUW scorecard measures achieved at least the threshold level of performance.

Performance was assessed against the following measures which support standards of performance and are regularly monitored on a UUW scorecard:

| **Scorecard measure** | **Achievement in 2011/12** |
|---|---|
| Underlying operating profit | Partially met target |
| Regulatory capital expenditure (spend) | Partially met target |
| Regulatory capital expenditure (outputs) | Partially met target |
| Customer service (Service Incentive Mechanism) | Partially met target |
| Serviceability | Partially met target |
| Corporate responsibility | Achieved target |

Details of the bonus payments made for the UUW PLC directors in respect of these measures for the year ended 31 March 2012 are as follows:

| **Director** | **Bonus re: UUW scorecard targets** |
|---|---|
| SL Mogford [(1)] | £530,069 |
| JR Houlden [(1)] | £299,667 |

[(1)] UUG PLC directors are remunerated by UUW PLC.

The bonuses shown above represent the amount of bonus payable under the bonus scheme which related to UUW scorecard targets.

A description of the other elements of the executive directors' remuneration is given in the 2012 Annual Report and Financial Statements of UUG PLC. For the forthcoming year, the UUG PLC incentive arrangements will continue to reflect the importance of achieving service standards. Performance will again be assessed against the same key measures including serviceability and Service Incentive Mechanism (SIM) scores, which are routinely used by Ofwat to assess standards of company performance.

The non-executive directors do not participate in the United Utilities bonus scheme, and were paid no remuneration linked to water service standards.

This note should be read in conjunction with note 5 to the UUW PLC annual report and financial statement, which provides information in respect of the total directors' remuneration.

# Supplementary regulatory information for the year ended 31 March 2012

**CERTIFICATE UNDER PARAGRAPH 6A.2A OF CONDITION F OF THE APPOINTMENTS TO WATER SERVICES REGULATORY AUTHORITY**

(1) In the opinion of the directors, United Utilities Water PLC will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next twelve months, the Regulated Activities (including the investment programme necessary to fulfil the company's obligations under the Appointments);

(2) In the opinion of the directors, United Utilities Water PLC will, for at least the next twelve months, have available to it the management resources which are sufficient to enable it to carry out those functions; and

(3) In the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to United Utilities Water PLC, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

**STATEMENT UNDER PARAGRAPH 6A.2B(1) OF CONDITION F OF THE APPOINTMENTS**

The directors of United Utilities Water PLC hereby state that, in giving the certificate under paragraph 6A.2A of Condition F of the Appointments, the main factors which they have taken into account are:-

- the financial position of the business at 31 March 2012 as represented by the statutory and regulatory accounts;
- projected cash flows as represented by the business plan and budget, treasury funding plan and estimated investment and operational requirements for the Regulated Activities;
- the anticipated managerial resources available; and
- the contract provisions with associated companies.

Certified as having been approved at a duly convened meeting of a committee of the Board of Directors of United Utilities Water PLC held on 1 June 2012.

_____

R Houlden

Director

1 June 2012

# Supplementary regulatory information for the year ended 31 March 2012 (continued)

**CERTIFICATE UNDER PARAGRAPH 3.1 OF CONDITION K OF THE APPOINTMENTS**

As required in paragraph 3.1 of Condition K of the Licence, the directors state that as at 31 March 2012, had a special administration order been made under Section 23 of the Water Industry Act 1991 in respect of the company, the company would have had available, in their opinion, sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company.

Certified as having been approved at a duly convened meeting of a committee of the Board of Directors of United Utilities Water PLC held on the 1 June 2012.

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R Houlden

Director

1 June 2012