

Registered number: 2366678

United Utilities Water PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 March 2008

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Managing Director's statement

Performance

United Utilities Water PLC has delivered a good set of financial results for the year ended 31 March 2008, marking a year of strong growth for the company.

Turnover increased by 8.2 per cent to £1,426.4 million, principally as a result of an allowed price increase of 4.4 per cent above inflation, which supports the increased levels of capital investment made this year to improve operational and environmental standards and services for our customers. Operating profit increased to £651.1 million, up 14.5 per cent on last year, primarily reflecting the allowed price increase, partially offset by a higher depreciation expense as a consequence of increased capital spend.

Capital investment was 45 per cent higher than last year, reflecting the peak phase of the company's 2005-10 expenditure programme. A revised strategy for processing and disposing of sewage sludge has recently been agreed with the Water Services Regulation Authority (Ofwat), which should reduce our carbon footprint. After adjusting for this strategy, cumulative capital expenditure on water and wastewater assets as at 31 March 2008 was broadly in line with regulatory assumptions. The business remains on course to meet its regulatory efficiency targets and deliver its outputs across the 2005-10 period.

It is likely that there will be additional capital investment required, in the order of £700 million, mainly in respect of Unsatisfactory Intermittent Discharges (UIDs) projects, that were not part of the company's 2005-10 regulatory contract. A large proportion of this investment, as already endorsed by the Department for Environment, Food and Rural Affairs (Defra) and currently awaiting determination by Ofwat, is expected to fall into the 2010-15 period and be considered as part of the forthcoming price review.

Looking beyond the financial results, the board has been pleased with progress on important areas such as leakage, water quality and customer satisfaction.

For the second consecutive year, the business outperformed its 2007/08 economic level of leakage rolling target of 465 megalitres per day, a tougher target than the previous year (2006/07: 470 megalitres per day). We are also pleased to report a 60 per cent reduction in the number of serious pollution incidents compared with two years ago. We have continued to remove properties from our sewer flooding register and have now achieved a net reduction of 32 per cent over the last two years and remain on course to achieve our medium-term target of a 50 per cent reduction. In addition there were no water restrictions on customers during the year.

The company supplies a high quality of drinking water, with a mean zonal compliance water quality performance of 99.94 per cent for the year (2006/07: 99.92 per cent). The company was ranked first among the United Kingdom's water and sewerage companies in 2006/07 by Ofwat for both water and wastewater in its most recent asset serviceability assessment, reflecting the company's long-term stewardship of its assets.

Good progress was made this year regarding customer satisfaction levels, with 73 per cent of customers surveyed who had made an enquiry being satisfied with the service received.

Strategy

The three key elements of our current strategic plan are:

- Continuing to improve our operational performance;
- Successfully delivering our 2005-10 regulatory contract; and
- Preparing for the 2009 water price review.

We aspire to be in the top quarter of the UK water sector on key operational measures in the medium-term. The business continues to upgrade its infrastructure and replaced 650 kilometres of water mains during 2007/08. Although the company has delivered real progress, there is more work to do in improving operational performance. During the year, there was a higher level of sewer flooding incidents influenced by adverse weather conditions. This, together with environmental underperformance at our Fleetwood wastewater treatment works will lead to a lower Overall Performance Assessment (OPA) score from Ofwat for 2007/08 compared with the prior year.

We are investing over £3 billion between 2005 and 2010 to improve our network assets on behalf of our customers and the environment. Successfully delivering the outputs required by Ofwat is of key importance and we have a clear plan for the remainder of this price review period and are confident of meeting our regulatory targets.

The 2009 water price review is a key value driver for us, as it will set the price limits from 1 April 2010 to 31 March 2015. We are currently developing our draft five-year business plan, scheduled for submission to Ofwat in August 2008. This plan forms the first element of the long-term vision for our business as it adapts to the changing climate and demographics of the north west.

In December 2007, we published our Strategic Direction Statement (SDS) entitled 'where we are heading', outlining the key issues facing the business over the next 25 years. The SDS is part of our preparation for the forthcoming price review and the six key elements are as described on page 8.

Managing Director's statement (continued)

The future

The company is pre-funded for its capital investment programme through to 2010. We recently improved our liquidity position by enhancing our committed medium-term bank facilities, providing us with increased flexibility in terms of when and how we raise further debt finance.

Our carbon action plan is progressing well through schemes which, in addition to helping the environment, also contribute to improving company efficiency. These schemes include targets for cutting emissions, increasing the efficiency of our pumping stations and using our wastewater processes to generate electricity and heat.

Stakeholders

We are committed to listening and responding to the needs of our stakeholders: employees, customers, investors, regulators and our commercial partners. Understanding their requirements and then managing and reporting our performance is central to how we run our business. The cornerstone of this approach is our employees and I would like to thank them for their continuing commitment and hard work.

Clive Elphick
Managing Director
11 July 2008

Operating and financial review

NATURE OF THE BUSINESS

Business overview

United Utilities Water PLC is a public limited company registered in England and Wales, providing wastewater and water services in north west England. The company was incorporated on 1 April 1989 under the Companies Act 1985.

United Utilities Water PLC is a subsidiary of United Utilities North West PLC which, in turn, is a wholly owned subsidiary of United Utilities PLC. The United Utilities PLC group (“the group”) is one of the largest operators of water and wastewater networks in the UK. This also includes the provision of operations and maintenance and shared services activities to Dŵr Cymru Welsh Water and acting as capital investment partners for Scottish Water and Southern Water. The group also operates electricity and gas networks and provides multi-utility metering and connections services.

Business description

The UK water industry is made up of local and regional companies operating the water and sewerage networks. Figure 1 shows the company’s operating boundary for the water and sewerage business. Under current legislation, domestic and small commercial customers have no ability to change their supplier. Ofwat is the economic regulator of the water and sewerage industry in England and Wales. Its role is to seek value for consumers.

The company’s activities comprise the operation of the licensed water and wastewater assets in north west England. This involves the removal and treatment of wastewater from, and the treatment and distribution of around 1.9 billion litres of water a day to, approximately 3.2 million homes and businesses.

The company’s activities are:

- capital intensive – improvements to the water and wastewater infrastructure are required in order to comply with applicable UK and European Union (EU) environmental and drinking water quality regulations. Capital investment (including infrastructure renewals expenditure) relating to water and wastewater in the year ended 31 March 2008 was £825 million;
- subject to economic regulation – in general, the business is subject to incentive-based economic regulation. This imposes caps on increases in customer prices, rewards efficiency and high standards of customer service and penalises inefficiency and poor standards of customer service; and
- subject to environmental regulations – these govern the abstraction of water, the quality of drinking water supplied to the company’s customers, the discharges it makes into the water environment and the management of potentially contaminated land the company owns, occupies or works upon.

Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of EU environmental initiatives (including the Water Framework Directive, the Drinking Water Directive and the Environmental Liability Directive).

The Wastewater business

The company is responsible for the reception, conveyance, treatment and disposal of domestic wastewater, trade effluent (non-domestic wastewater) and surface water in north west England.

The company’s wastewater treatment works provide a range of treatments. These include primary, secondary and tertiary treatment involving a variety of physical, chemical and biological processes. These aim to ensure the constituents of wastewater are effectively modified before discharge. Fully treated final effluent is discharged into rivers, estuaries or via sea outfalls. The Environment Agency consents to and stringently monitors all these discharges to ensure they comply with all relevant limits. A by-product of the treatment of wastewater is sewage sludge, which is further treated to produce an end product that is suitable for recycling.

The wastewater operations involve owning and managing assets, which include:

- 582 wastewater treatment works;
- 43,419 kilometres of sewers;
- 1,826 pumping stations;
- 143 detention tanks;
- 2,275 combined sewer overflows and 375 emergency overflows; and
- 42 sludge treatment facilities.

Figure 1: Water and wastewater operating boundary



Operating and financial review (continued)

NATURE OF THE BUSINESS (CONTINUED)

The Water business

The company obtains water from various sources including reservoirs, rivers and aquifers. A large proportion of the water that the company supplies flows freely by gravity and does not need to be pumped. However, due to the nature of the water catchment areas, being peaty moorlands or coal measure strata, enhanced treatment methods are required to ensure the water satisfies all regulatory and quality standards.

This untreated water is conveyed to treatment works by aqueducts. Treated water is delivered to the company's customers through a network of large diameter trunk mains to smaller trunk mains, service reservoirs, water towers and distribution mains.

The company owns, operates and manages the water network assets in north west England which include:

- 137 operational and one emergency impounding reservoirs and associated catchments;
- 95 operational and five emergency water treatment works;
- 450 service reservoirs and water towers storing treated water;
- 609 pumping stations; and
- 42,219 kilometres of clean water mains.

The company owns approximately 57,800 hectares of catchment land. The key reason for owning and managing this land is to protect and improve the quality of raw water supplies and thus reduce the risk of non-compliance at water treatment works and avoid unnecessary operating costs.

In the 2004 price review, the company obtained funds of £10 million for an innovative approach to land management entitled the 'Sustainable Catchment Management Programme' (SCaMP). This programme seeks to restore moorland areas so as to meet the government's Public Service Agreement targets to bring Sites of Special Scientific Interest into good condition.

At the same time, the company seeks to enter into long-term agreements with tenant farmers to reduce livestock to acceptable levels so that, once restored, the moorland areas will be protected for the future. This integrated holistic approach should bring multiple benefits. As well as delivering the government's biodiversity targets, it is anticipated that there will be improvements in raw water quality (relating in particular to colour) and potentially reduced risk of downstream flooding.

The programme has just completed its third year and is being applied to all the farms owned on both our Bowland and southern estates, and we have been successful in concluding agreements with tenant farmers covering over 90 per cent of the land area in the programme to enable this to happen. Substantial work is now underway in both areas.

The company's capital investment (including infrastructure renewals expenditure) for the year to 31 March 2008 was £825 million. This represents an increase in expenditure of 45 per cent when compared with the previous financial year and reflects the planned profile of the group's investment programme. Cumulative capital expenditure on water assets as at 31 March 2008 matched regulatory assumptions.

Operating and financial review (continued)

REGULATORY DEVELOPMENTS

The UK government awarded Instruments of Appointment ('licences') for the provision of wastewater services and water supply in 1989. These licences continue in force for an indefinite period, subject to potential termination rights as set out below. The company holds the licence for an area of north west England which comprises 3.2 million homes and businesses. The Water Industry Act 1991 (the 'Act'), as amended by the Water Act 2003 (the 'WA 2003'), provides for the appointment (by way of licensing) of water and wastewater undertakers. Economic regulation pursuant to these licences is currently the responsibility of Ofwat. Ofwat also exercises powers under UK competition legislation, most significantly the Competition Act 1998 and the Enterprise Act 2002.

Ofwat regulates wastewater and water charges by capping the average increase in charges that a company can impose in any given year. Ofwat conducts a price review and sets price caps every five years. Ofwat has announced that it intends to maintain this five-year price control but that it will place price limits within a longer term framework. For example, it will ask water companies for a 25-year business plan at the next price control review in 2009.

This price cap is set by Ofwat by reference to inflation as measured by the retail price index in the UK plus an adjustment factor known as 'K', which is specific to each company and which can vary for each year of the review period. The size of a company's K factor (which can be positive, negative or zero) reflects the scale of its capital investment programme, its cost of capital and its operational and environmental obligations, taking into account the scope for it to improve its efficiency. 'Price cap' regulation, as operated in the UK, is performance based: companies are incentivised to be efficient, both in terms of their operating costs and in the implementation of their capital expenditure programme.

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 customers via the subsequent price setting process. The cost of any under-performance due to poor management is borne by the companies. Companies are also incentivised to provide a high quality of service and penalised if they provide a poor quality of service by means of an adjustment to the K factor at the subsequent price review.

The last price review was completed in December 2004 and covers the period from 1 April 2005 to 31 March 2010. In the last review, Ofwat set the following K factors, being the amount by which prices are allowed to rise above inflation in each of the five financial years commencing on 1 April 2005:

2005/06	5.0 per cent
2006/07	6.4 per cent
2007/08	4.4 per cent
2008/09	3.5 per cent
2009/10	3.0 per cent

This equates to a real (i.e. excluding inflation) average annual price increase over the five-year period of 4.5 per cent. Ofwat is currently reviewing its cost base methodology in preparation for the next price review. Unexpected costs or savings arising from changes in certain regulatory assumptions during a review period are recorded and agreed by the company and Ofwat. This process, known as 'logging up and down', allows prices to be adjusted up or down at the next price review to compensate (companies or customers) for the unexpected change. In addition, where the change exceeds the specified materiality thresholds, the company can request, and Ofwat can instigate, a re-setting of its price limit during the five-year period, known as an Interim Determination of K ('IDoK'). All water and sewerage companies' licences now include a 'shipwreck' or 'substantial effect' clause, which allows companies' price limits to be revised when events beyond their control have had a significant effect on their costs or turnover.

Environmental regulation

The water and wastewater industry in the UK is subject to substantial domestic and EU regulation, placing significant statutory obligations on the company with regard to, among other factors, the quality of treated water supplied and of wastewater treatment. European Directives (including the Drinking Water Directive, the Bathing Water Directive and the Urban Wastewater Treatment Directive) are transposed into UK law by primary and secondary legislation.

All water and wastewater companies have a general duty to exercise their powers to conserve and enhance natural beauty 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, which is responsible for conserving and redistributing water resources and securing the proper uses of those resources, including the licensing of water abstraction. The Agency also regulates discharges to controlled waters including discharges from wastewater treatment works;
- The Drinking Water Inspectorate, which enforces drinking water quality standards; and
- Natural England, (formerly English Nature), 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 conserve or improve biodiversity. As a result of new UK government targets, Natural England is seeking improvements to approximately 50 per cent of the sites within the company's ownership.

Operating and financial review (continued)

REGULATORY DEVELOPMENTS (CONTINUED)

Strategic Direction Statement

Consistent with its approach to longer-term asset planning, in December 2007 the company published its Strategic Direction Statement (SDS) which considers the needs of the north west region out to 2035. The SDS enables the company to set its plans for the next price review period (2010-15) in this longer-term context, develop sustainable solutions and respond to future challenges.

The six key elements identified in the SDS are:

- **Responsible long-term stewardship of networks.**

This includes protecting health and the environment, improving understanding of network performance and investing in research and new technology with clear efficiency and service benefits.

- **Listening and responding to the views of customers and other stakeholders.**

Ensuring that the company's plans meet the changing needs and priorities of customers and other stakeholders and provide good value for money. The company recently undertook a substantial customer survey which identified key areas where customers are willing to pay for improvements including supply interruptions, sewer flooding, odour and reductions in greenhouse gas emissions. Customer priorities can help shape future investment programmes, aligning expenditure to those areas that customers consider most important.

- **Making water resources more sustainable and resilient.**

This means improving both the company's own and customers' water efficiency, ensuring the company enhances and protects its network and developing water resources to help address increasing drought risk and meet supply and demand requirements.

- **An integrated approach to drainage to reduce flooding risk.**

Storm water volumes entering the sewer system need to be reduced and the government's proposal to transfer responsibility for private sewers from householders to water companies will facilitate a more integrated approach to this challenge.

- **Reduce the company's carbon impact.**

The company aims to work together with the other companies in the United Utilities group to halve the group's greenhouse gases by 2035, supported by achieving energy neutrality for its wastewater operations.

- **Bills to rise, on average, no faster than incomes.**

The company believes that the water and wastewater services it provides are already of good value, but there will be future upward pressure on costs.

Climate change and sustainability

The implications of climate change on drought and flood risk are set to feature strongly in the company's plans for decades to come and these implications will be incorporated in the forthcoming price review submission. The importance of this is recognised by the government, which intends to publish a draft Floods and Water Bill for consultation later in the year.

Operating and financial review (continued)

REGULATORY DEVELOPMENTS (CONTINUED)

2009 water price review

The company's preparations for the forthcoming price review are well advanced and it is in active deliberations with its regulators and other key stakeholders. In March 2008, Ofwat published its methodology for the 2009 water price review which will set price limits for the five-year period starting 1 April 2010. In many respects, the methodology is similar to that used in previous price reviews but the company is pleased to note the increased focus on the issues of climate change and sustainability.

Following the outcome of the United Utilities group's recent capital structure review, the company's board announced that it will be targeting an A3 credit rating for the company which it believes best mirrors Ofwat's assumptions for the 2005-10 regulatory period. The company's board believes this to be an appropriate investment grade rating to allow the company to raise finance to fund its substantial capital investment programmes.

The company believes that Ofwat should ensure that companies can at least maintain an A3 rating and should consider recent developments in the credit markets. The raising of debt finance is particularly important given the likely scale of investment that is still required in the water industry to replace and refurbish ageing infrastructure, address flooding risk and climate change and deliver further statutory environmental obligations and customer priorities. The company believes significant investment will be required during the next price review period (2010-15) and beyond.

Unsatisfactory Intermittent Discharges (UIDs)

It is likely that there will be additional capital investment required, mainly in respect of UID projects, that were not part of the company's 2005-10 regulatory contract. A large proportion of this investment, as already endorsed by Defra and awaiting determination by Ofwat, is expected to fall into the 2010-15 period and be considered as part of the forthcoming price review. The company estimates that the additional funding likely to be required to complete this UID programme, which is designed to meet statutory obligations and deliver environmental benefits, could be in the order of £700 million.

RESOURCES

People

The company has been working over the past year to define what leadership across our business should look like. Our senior leaders have attended development workshops as part of this process and we are establishing a leadership communications forum aimed at sharing knowledge and information.

To attract, retain and develop skills and talent across the company a key part of the human resources strategy focuses on building a skills and talent pipeline. This strategy details the skills, capabilities and numbers of people the company needs for future success. The company intends to grow internal talent and attract talent from the external market to bridge any gaps it has. A 'university' concept has been developed to provide development support in leadership, technical and core skills. This will be launched to employees during 2008.

The company's employees are fundamental to its business success. It is vital they understand the business direction, feel pride in their work and are motivated to go the extra mile for their customers. Therefore, the company now measures how engaged its employees feel, rather than how satisfied they are with their jobs. In 2007/08, 71 per cent of the company's people said they felt engaged and fully supported the business. The company's ambition for 2008/09 is to increase this score to 78 per cent through targeted action plans.

The company has introduced consistent health and safety standards supported by improved checks and a greater safety awareness and competence among its employees. This allows the company to focus on reducing and measuring risk control rather than just dealing with accidents in isolation. This new approach to health and safety management will also ensure that all employees maintain the right knowledge, skills and competence levels to work as safely as possible.

We offer our employees a set of core benefits which range from holidays and pension schemes to health checks and family-friendly benefits. Pension provision is a valued core benefit and 90.5 per cent of employees are members of the group's schemes, some of which offer an Additional Voluntary Contribution facility. We recognise the importance of work-life balance and have developed a range of initiatives that go beyond our legal obligations as an employer. These include our policies on maternity, paternity, adoption, family, personal and special leave. We offer flexible working, career breaks, part time working, job-share, home working and a range of additional benefits. This year we extended the flexible benefits scheme to all our employees.

Our business principles make it clear that in everything we do, we act with integrity and fairness and observe legal requirements. Any employee with serious concerns that we may not be adhering to these principles is encouraged to speak up via their line manager or by using a voicemail number that can be called in confidence.

The company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, the company gives equal consideration to applicants with disabilities in its employment criteria and will modify equipment and working practices wherever it is safe and practical to do so. The company is committed to providing full support and appropriate training for employees who become disabled during the course of their employment so that they can continue to work in a position appropriate to their experience and abilities.

Operating and financial review (continued)

RESOURCES (CONTINUED)

Operating facilities

As at 31 March 2008, the company had the principal operating facilities and offices shown in the table below, all of which are owned and are freehold, except Sandon Dock which is leasehold.

Principal operating facilities

Location	Description	Approximate area in hectares
Bowland Estate, Lancashire	Reservoir/gathering grounds	10,120
Haweswater Estate, Cumbria	Reservoir/gathering grounds	10,522
Longendale Estate, Derbyshire	Reservoir/gathering grounds	10,215
West Pennine Moors, Lancashire	Reservoir/gathering grounds	5,564
Thirlmere Estate, Cumbria	Reservoir/gathering grounds	4,850
Davyhulme, Greater Manchester	Wastewater treatment works	113
Huntington, Cheshire	Water treatment works	107
Prescot, Merseyside	Water treatment works	84
Woodgate Hill, Greater Manchester	Water treatment works	40
Sandon Dock, Liverpool	Wastewater treatment works	8
Shell Green, Widnes	Sludge processing centre	5

Note: One hectare equals 2.47 acres

Principal offices

Location	Description	Floor area in sq. ft.	Utilisation
Lingley Mere, Warrington	Company offices	259,622	100%
Winsford, Cheshire	Company offices	20,441	70%

In addition to the properties described above, the company occupies various non-operational properties consisting primarily of offices, depots, warehouses and workshops. These are either owned or leased by the company. It is anticipated that the company will be able to negotiate renewals of any expiring leases, or relocate the relevant facilities, without having a material adverse impact on the company.

INTERNAL CONTROL

The company operates an internal control system to evaluate and manage risks. The board is responsible for the company's system of internal controls and for reviewing its effectiveness. Each year management reviews all controls including financial, operational and compliance controls and risk management procedures. The internal control system is designed to manage, rather than to eliminate, the risk of failure to achieve the company's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The key features of the internal control system are:

- a control environment with clearly defined organisation structures operating within a framework of policies and procedures covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- established procedures, set out in an internal control manual, for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews;
- a monthly board review of financial and non-financial performance to assess progress towards objectives;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements and internal audit reviews;
- an internal audit function which provides independent scrutiny of internal control systems and risk management procedures;
- regular monitoring of risks and control systems throughout the year, supported by the use of risks and issues databases;
- a self-certification process, whereby management is required to confirm annually that the system of internal control is operating effectively;
- an annual risk assessment exercise involving self-assessment by management of all business risks in terms of impact, likelihood and the strength of related internal controls; and
- health and safety performance reviews carried out by the company's in-house health and safety professionals in addition to the normal health and safety risk assessment and management processes carried out within each of the operating businesses.

Operating and financial review (continued)

PRINCIPAL RISKS AND UNCERTAINTIES

The company is exposed to a variety of risks and uncertainties which, if they materialise, could adversely affect the company's reputation, profitability or financial position, and the pricing and liquidity of the company's securities. The principal risks and uncertainties to which the company is exposed are summarised below, but other risks and uncertainties, or risks and uncertainties that are unforeseen or unforeseeable could also have an adverse impact on the company's reputation, profitability or financial position, and the pricing and liquidity of the company's securities.

Regulation

The company operates in a regulated industry and its water and wastewater businesses are substantially influenced by the service levels, regulatory targets and price determinations made by its primary regulator, Ofwat, and Ofwat's assessment of its delivery against those service levels, regulatory targets and price determinations. The most recent price determination in 2004 set price limits for the five years from April 2005. The next price determination in 2009 will take effect for five years from April 2010.

An adverse price determination could occur for a number of reasons, including an inadequate allowed cost of capital or inadequate assumptions by Ofwat concerning the company's future operating and capital expenditure, as well as turnover forecasts proving not to be sufficiently accurate. In addition, unforeseen or unforeseeable costs may arise after a price determination which were not taken into account by Ofwat in setting price limits and cannot be passed on to customers. Scope for the company to review a particular price determination within the relevant five-year period is limited. These review mechanisms can also be invoked by Ofwat to reduce the prices the company can charge its customers.

Ofwat is empowered to impose fines on the company of up to 10 per cent of its regulated turnover if it fails to comply with its regulatory obligations. Furthermore, if the company provided a sub-standard service to customers or failed to comply with reporting requirements, then in serious cases, the company's licences could be revoked. The company engages regularly with Ofwat and its other regulators within the applicable statutory framework, and endeavours to ensure that the assumptions and projections underlying Ofwat's price determinations are accurate and achievable.

Operational performance and cost savings implicit in price determinations

Operating cost savings are implicit in Ofwat's price determinations. To assist the achievement of these operating cost savings, the company has introduced a business change programme. If these efficiencies are not achieved, this may adversely affect the company's profitability and may be reflected by less favourable outcomes in Ofwat's future price determinations.

Events, service interruptions, water shortages or contamination of water supplies could adversely affect profitability

The company controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. In exceptional circumstances the failure of an asset, or an element of a network, or supporting plant or equipment could result in catastrophic damage, including significant loss of life and/or environmental damage and/or economic and social disruption. In less exceptional circumstances, the failure of a key asset could cause a significant interruption to the supply of services. Although the company has continued to refine its risk management and business continuity procedures, it is only possible to be reasonably, but not absolutely, certain 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 has a duty to supply water that is wholesome at the time of supply. The Drinking Water Inspectorate is required to take enforcement action against the company for any breach of quality standards or other statutory obligations. In addition, the company may be prosecuted and fined or face claims from third parties for supplying water that is unfit for human consumption.

Water supplies may be subject to interruption or contamination, including contamination from the presence of naturally occurring compounds and pollution from man-made sources or third parties' actions. The company could be fined for breaches of statutory obligations or held liable to third parties for human exposure to hazardous substances in its water supplies or other environmental damage. If a water supply provided by the company is contaminated or interrupted and the company is unable to substitute water supply from an uncontaminated water source, or to treat adequately the contaminated water source, the company is required to provide an alternative water supply of equivalent quality, which could increase costs.

Water shortages may be caused by periods of below average rainfall, long-term increases in demand, short-term exceptional demand or operational problems involving water abstraction, transmission, treatment, storage or distribution. Environmental considerations such as climate change may exacerbate seasonal fluctuations in supply availability. A combination of any or all of these factors may require restrictions on the use of water, including hosepipe bans and drought orders. If there are water shortages, the company may incur additional costs in order to provide emergency reinforcement to supplies in areas of shortage, which may have an adverse effect on the company's profitability or financial position.

Although these costs may be recoverable in part through the regulatory price determination process, there can be no assurance of this. The company actively monitors these risks and maintains insurance policies in relation to losses and liabilities likely to be associated with these risks, although there can be no assurance that cover will extend to the entirety of such losses or liabilities, or that coverage will continue to be available in the future.

Operating and financial review (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Capital investment programmes

The company requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities. The price determinations made by Ofwat take into account the level of capital expenditure that Ofwat expects the company to incur during the relevant five-year price review period and the associated funding costs.

Historically, the company has financed this capital expenditure from operating cash flows and from external debt financing. There can be no assurance that operating cash flows will not decline or that, in the longer term, external debt financing or other sources of capital will be available at similar expense in order to meet these capital expenditure requirements.

If the company is unable to deliver on its capital expenditure programmes, adverse legacy effects of earlier capital investment emerge or amounts budgeted in prior capital expenditure programmes prove insufficient to meet the actual capital expenditure required, the company's profitability or financial position may be adversely affected. In addition, the company's ability to meet regulatory and other environmental performance standards could be adversely affected by such failure, which may result in fines imposed by Ofwat of an amount of up to 10 per cent of regulated turnover, or other sanctions.

At the beginning of the 2005-10 price determination period, there had been around 3,000 intermittent discharges recorded in north west England from wastewater overflows, of which a number were determined by the Environment Agency as "unsatisfactory" (UIDs). There have been ongoing discussions between the company, Ofwat and the Environment Agency regarding the responsibility, scope and cost of the required solutions for a number of these UID. The majority of these UID projects were not part of the 2005-10 regulatory contract and will require additional investment.

In October 2007 the company submitted a funding submission, or change protocol, to Ofwat relating to discharges into inland waters. This submission followed a planning inquiry which dealt with a small number of such UIDs but which was intended to establish precedent for a larger number of similar discharges that were under discussion. The required investment at the sites included in the change protocol submission has now been endorsed by Defra. A further planning inquiry dealing with discharges to bathing waters was heard in December 2007. The company will be making further submissions to Ofwat dealing with those UIDs affected by that planning inquiry as well as other UIDs.

Taken together, the company currently estimates that funding for capital expenditure of approximately £700 million is likely to be required in order to remedy these UIDs. A large proportion of this capital expenditure is likely to fall into the 2010-15 regulatory period and so the funding of this investment will be considered as part of the forthcoming 2009 price review. This investment programme, if fully endorsed by Defra and Ofwat, should be funded through price limits and deliver additional growth in the company's regulatory capital values as well as benefits for customers and the environment. The company cannot be certain, however, that all these additional costs will be recoverable on this basis and will not adversely affect the company's profitability or financial position.

Non-recovery of customer debt

The company manages the billing, cash collection and debt management activities for over three million domestic and business wastewater and water customers. Legislation prohibits the disconnection of a water supply to domestic premises for non-payment, as well as the limiting of a supply with the intention of enforcing payment in respect of certain connections, including those to domestic dwellings.

Non-recovery of customer debt may cause the company's profitability to suffer. Although allowance is made by Ofwat in its periodic price determinations for a proportion of debt deemed to be irrecoverable, the company can also initiate a review during a price determination period when certain regulatory assumptions (including as to the level of non-recoverable debt) are materially inaccurate, although there can be no guarantee that these reviews will be successful.

Operating and financial review (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Environmental laws

There are various environmental laws with which the company must comply. These laws establish, amongst other things, standards for water abstraction, drinking water, the discharge of sewage and other pollutants into the environment, and procedures governing operational development. The company is required to obtain various environmental consents from regulators.

In particular, the company is required to comply with laws intended to control the release of, or exposure to, contaminants that are potentially harmful to health, safety or the environment. Land that is designated as contaminated land may need to be remediated, and the company could be liable for the cost of remediation of land owned or occupied by it if the original polluter cannot pay. The company owns a significant number of sites and operates upon or within land owned, tenanted or trafficked by third parties.

None of the company's land is currently designated as contaminated but it owns, or is required to work within or may in future own or be required to work within, sites that, by virtue of prior use, are potentially contaminated. Whilst the company has implemented risk controls intended to effect compliance, it is possible that there may be liability in relation to contaminated land in future and the company could face sanctions imposed by the relevant regulator or the courts or claims by third parties.

While the company endeavours to comply with all legal requirements, it cannot guarantee that in the future it will be in full compliance at all times with all applicable environmental laws and the terms and conditions in its environmental consents. Should it fail to comply, the company could face fines imposed by the courts or otherwise face sanction by the relevant regulator or claims from third parties and additional costs to bring the company into compliance.

In addition to regulatory compliance proceedings, the company could become involved in a range of third party legal proceedings relating to land use, environmental protection and water quality, which could include planning permission applications for, for example, sewage treatment or water treatment works; challenges by third parties to decisions relating to the company that have been made by regulators; and civil actions by third parties for the alleged infringement of their common law rights, such as nuisance claims relating to odour or other matters. These risks could adversely affect the way that the company operates, prejudice its reputation and result in the imposition of substantial fines, damages and other costs, each of which could adversely affect profitability and the company's financial position.

The Water Act 2003 (the 'act') has implemented changes to the regulatory regime. The scope and timing of the government's plans under the act to transfer ownership of parts of the sewerage system which are in private ownership to sewerage undertakers have yet to be finalised and the company may incur costs as a result of such a transfer, for example in meeting the costs of any upgrading and maintenance work that may need to be carried out in respect of the transferred sewers. Further, the act has introduced new time-limited water abstraction licences which must be renewed upon expiry. The renewal of these licences is now subject to certain tests and the company's abstraction licences may not be renewed. Additional costs could be incurred in implementing replacement projects.

Pension scheme obligations

The company participates in a number of United Utilities group pension schemes. The principal schemes are funded defined benefit schemes and the assets of the schemes are held in trust funds independent of company finances. In respect of the company, the current schemes had a combined deficit of £48.6 million as at 31 March 2008, compared with a surplus of £11.8 million as at 31 March 2007 (see note 21). This funding position may vary over time, in particular if short-term investment performance does not match changes to the value of the liabilities.

However, further increases to the deficit may result in a liability for the company, even though some of the additional deficit may be recoverable through the regulatory price determination process.

Operating and financial review (continued)

LONG TERM STRATEGY, BUSINESS OBJECTIVES AND PERFORMANCE

The company's vision is to be a world class owner and operator of utility infrastructure. The company is targeting an upper quartile position on key operational and service measures in the medium-term whilst simultaneously outperforming financially its regulatory contract (effective April 2005) pursuant to which the company operates the water and wastewater networks.

Operational performance

The company's strategy is built upon the key enabler of a high performance culture and the achievement of a long term sustainable operating model. Building on the progress that has been made in the last two years, this requires significant transformational change of the business over the next two years in the way it will enhance expenditure planning and manage its assets and workforce. The company has identified a number of Key Performance Indicators (KPIs) against which it would assess its performance:

Operational KPI	Target	Performance update
Relative efficiency	to be upper quartile in the medium-term	The company has closed the operational efficiency gap to the most efficient water companies over the last two years. For the water service the company has narrowed the gap from 16 per cent to 12 per cent and for the wastewater service from 27 per cent to 18 per cent (based on the company's internal estimates). This is reflected in Ofwat's 2006/07 assessment as band B for the water service and band C for the wastewater service and represents a one band improvement for both services over the two-year period.
Security of water supply (leakage)	to meet or outperform rolling leakage targets and avoid the need for water restrictions	The company outperformed the tougher economic level of leakage rolling target of 465 megalitres per day, as set by Ofwat for 2007/08. This is the second consecutive year that the company has met or outperformed its leakage target. In addition, there were no water restrictions on customers during the year.
Pollution	to reduce incidents by at least 50 per cent in the medium-term	One water and eight wastewater Category 1&2 incidents were recorded in 2007 compared with the base position of two water and 21 wastewater incidents in 2005. The company again outperformed its target of a 50 per cent reduction in the medium-term.
Sewer flooding	to reduce incidents by at least 50 per cent in the medium-term	The company continued to remove properties from its sewer flooding register. A medium-term target of reducing the number of properties on this register by 50 per cent compared with a start point of 641 properties in 2005/06 has been set. This target is based on properties at risk of experiencing at least one sewer flooding incident in ten years. Further progress has been made in 2007/08 with 434 properties now on the register. This represents a 32 per cent reduction over the last two years and the business remains on track to meet its medium-term target.
Overall customer satisfaction	85 per cent in the medium-term	Good progress was made in 2007/08 and 73 per cent of the company's customers surveyed who had made an enquiry were satisfied with the overall service they received. This compares with a start point satisfaction level of less than 50 per cent in 2005. These satisfaction levels are based on a comprehensive independent survey conducted on behalf of the company each month. Going forward, the business has a strong focus on resolving customer queries on the first contact which should improve customer satisfaction and lower the cost of service.

The company has a vision to be a world class operator of utility infrastructure and is targeting an upper quartile position among UK water companies on key operational measures in the medium-term. The business continues to upgrade its infrastructure and replaced 650 kilometres of water mains during 2007/08 (2006/07: 810 kilometres). The company supplies a high quality of drinking water, with a mean zonal compliance water quality performance of 99.94 per cent for the year (2006/07: 99.92 per cent). The company was ranked first among the UK's water and sewerage companies in 2006/07 by Ofwat for both water and sewerage in its most recent asset serviceability assessment, reflecting the company's long-term stewardship of its assets.

Although the company has delivered real progress, there is more to do in improving operational performance. During 2007/08 there was a higher level of sewer flooding incidents influenced by adverse weather conditions. This together with environmental underperformance at the company's Fleetwood wastewater treatment works will lead to a lower Overall Performance Assessment (OPA) score from Ofwat for 2007/08, compared with the prior year.

Operating and financial review (continued)

LONG TERM STRATEGY, BUSINESS OBJECTIVES AND PERFORMANCE (CONTINUED)

Performance

The company monitors a large number of financial and non-financial KPIs, including targets set by Ofwat. Performance in 2007/08 against these measures is set out in the table below, together with the prior year performance data.

Performance against KPIs

	2007/08	2006/07
Financial		
Turnover ⁽¹⁾	£1,426.4m	£1,318.2m
Operating profit	£651.1m	£568.7m
Profit before tax	£457.5m	£431.0m
RCV gearing ⁽²⁾	53%	49%
Interest cover ⁽³⁾	2.9	2.6
Capital expenditure (net cash flow)	£721.3m	£537.7m
Environment		
Pollution incidents ⁽⁴⁾	9	9
Water quality - mean zonal compliance ⁽⁵⁾	99.94%	99.92%
Greenhouse gas emissions ⁽⁶⁾	0.512mtCO ₂ (e)	0.489mtCO ₂ (e)
Renewable energy generated	93.3GWh	78.6GWh
Employees		
Employee engagement – employee opinion survey ⁽⁷⁾	71%	n/a
Customers		
Water - relative efficiency banding ⁽⁸⁾	Band B ^(2006/07)	Band B ^(2005/06)
Wastewater - relative efficiency banding ⁽⁸⁾	Band C ^(2006/07)	Band C ^(2005/06)
Leakage - rolling annual average leakage ⁽⁹⁾	462Ml/day	468Ml/day
Sewer flooding - number of properties on the at-risk register ⁽¹⁰⁾	434	469
Overall customer satisfaction – water (in response to enquiries)	73%	68%
Overall Performance Assessment (OPA) ⁽¹¹⁾	343 points	385 points

⁽¹⁾ Turnover is the consideration receivable by the company for services provided during the year.

⁽²⁾ RCV gearing is measured as borrowings net of cash and short-term deposits divided by the Regulatory Capital Value (RCV). The RCV is a company-specific measure calculated by Ofwat, which is widely used in the investment community as a component of the market value of regulated water businesses.

⁽³⁾ Interest cover is the number of times the net underlying finance expense is covered by operating profit before exceptional charges. Net underlying interest expense is calculated as the underlying cost of borrowings excluding any pension adjustment and movements in the fair value of debt and derivatives but including the £41.8 million (2006/07: £52.9 million) interest on swaps and debt under fair value option.

⁽⁴⁾ Number of category One and Two incidents during the year as defined by the Environment Agency. Figures stated are for the years to 31 December 2007 and 2006.

⁽⁵⁾ Mean zonal compliance is used as an indicator of the overall quality of water as measured at the consumer's tap. It is constituted from data for 40 parameters with National or European standards. Figures stated are for the years to 31 December 2007 and 31 December 2006.

⁽⁶⁾ Incorporates the increase in Defra's carbon dioxide emission factor. Note, mtCO₂(e) represents 'million tonnes of CO₂ emissions (or their equivalent)'.

⁽⁷⁾ This is a new measure designed to provide a more in-depth analysis than employee satisfaction as discussed on page 9.

⁽⁸⁾ Relative efficiency is the operating expenditure relative efficiency band as assessed by Ofwat for the years to 31 March 2007 and 31 March 2006.

⁽⁹⁾ Annual rolling average leakage – figures given are in megalitres per day for the years to 31 December 2007 and 31 December 2006. The Ofwat Regulatory rolling average leakage target was 465 megalitres per day.

⁽¹⁰⁾ The register records properties at risk of experiencing one sewer flooding incident in ten years.

⁽¹¹⁾ As the Overall Performance Assessment (OPA) at March 2008 has not been confirmed by Ofwat this represents the company's current best estimate. The OPA is a measure used by Ofwat to compare the quality of the overall service that water companies provide to their customers across a basket of measures. The figure now quoted for 2006/07 is the actual assessment.

Operating and financial review (continued)

LONG TERM STRATEGY, BUSINESS OBJECTIVES AND PERFORMANCE (CONTINUED)

Financial performance

Turnover increased by 8.2 per cent to £1,426.4 million in 2007/08, principally as a result of allowed price increases of 4.4 per cent plus RPI of 3.9 per cent, offset to a small extent by lower water consumption and trade effluent volumes and the retrospective claims by unmetered customers. The increase in price supports the investment of significant sums in improving the infrastructure which provides vital clean water and wastewater services to customers.

Operating profit increased by 14.5 per cent to £651.1 million in 2007/08, primarily reflecting the allowed price increase, partly offset by higher depreciation expense as a consequence of increased capital spend and increased doubtful debt charges, due to the embedding of new service provider arrangements and increasingly challenging economic conditions affecting the propensity to pay.

Net interest payable for the year increased by 40.6 per cent to £193.6 million in 2007/08. This increase is the result of higher borrowings during the year and a fair value loss of £19.8 million on debt and derivative instruments (2006/07: £22.4 million gain). This volatility in the fair value reflects the fact that, in order to hedge the interest cost implicit in the regulatory contracts, the company fixes interest rates for the duration of each five-year review period for the majority of its debt using interest rate swaps. Financial Reporting Standard (FRS) 26 'Financial Instruments: Recognition and Measurement' limits the use of hedge accounting for these commercial hedges, thereby increasing the potential volatility in the profit and loss account. In addition, the impact of changes in credit spread on debt accounted for at fair value through profit or loss can result in significant additional volatility. However, this volatility has no cash flow impact. Interest payable on swaps and debt under the fair value option was £31.9 million (2006/07: £53.5 million).

The current UK mainstream corporation tax charge for 2007/08 reflects the high level of accelerated tax allowances arising from the capital investment undertaken by the company. The effective current tax charge is 21.0 per cent, compared with a charge of 17.6 per cent in 2006/07. Including deferred tax, there is an effective tax charge of 20.3 per cent, compared with 22.6 per cent in 2006/07.

Net cash generated from operating activities increased to £963.7 million, from £867.5 million in 2006/07. A significant level of capital investment continues to be made and reflects the peak phase of the 2005-10 water and wastewater capital investment programme. The 2007/08 net capital investment spend of £721.3 million represents a 34.1 per cent increase over 2006/07, reflecting the planned rephasing of the AMP4 capital programme.

Short-term deposits of £1,307.0 million were drawn down in the year, being utilised through the increased capital spend and the set up of a new inter-company loan structure of £497.5 million. Borrowings, net of cash and short-term deposits, increased by £532.3 million to £3,906.8 million at 31 March 2008. RCV gearing, measured as borrowings net of cash and short-term deposits divided by the regulatory capital value, increased to 52.9 per cent compared with 49.0 per cent at 31 March 2007.

In the 2007/08 financial year, dividends of £299.3 million were recognised. This figure represents a dividend payment relating to the financial year 2006/07 of £196.3 million and an interim payment relating to 2007/08 of £103.0 million. The board has recommended a final ordinary dividend for 2007/08 of £220.0 million as well as a special dividend of £550.0 million (see capital structure section on page 17).

Regulatory accounts measures

Atypical operating expenditure items

Atypical costs in the year included customer transition costs of £5.6 million, which represent consultancy costs associated with the Customer Transformation Programme. The Transformation Programme is designed to deliver tools and techniques, improved processes and performance management into the customer services operation to enable a substantial improvement in productivity and performance. Also included is £2.0 million in respect of Huyton incident costs, related to the insurance excess paid to cover two separate bursts along Liverpool Road and restructuring costs specifically around the support service reorganisation of £4.5 million. The restructuring costs of £4.5 million have been treated as exceptional charges in the statutory and regulatory accounts. There is been no atypical income in the current year (2006/07: £4.9 million).

Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation

The annual regulatory accounts' infrastructure renewals charge continues to be based on the current five-year business plan plus the ten year (2010 to 2020) annual expenditure projections submitted at the 2004 price review (PR04). The 2007/08 charge is £117.4 million, compared to £113.0 million in 2006/07. The current cost depreciation charge attributable to the company (net of amortisation of deferred grants) for the year of £305.6 million compares with the Final Determination assumption of £327.7 million. This reduction of £22.1 million is due largely to lower capital expenditure in this and the previous two years, and the impact of the company's PR04 asset revaluation.

Donations to charitable trusts assisting customers or similar funds

During the year, the company has made donations of £3.0 million to the United Utilities Trust Fund, an independent charitable trust helping customers in genuine financial difficulty with both water and non-water debts and in addition providing monies to third parties to promote money advice work. This is in line with the agreed donation profile and has been expensed via the profit and loss account.

Operating and financial review (continued)

CAPITAL STRUCTURE

Overview

The board has reviewed the business plan and considers that the company has sufficient liquidity to meet its anticipated financial commitments for at least the next twelve months.

The company's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cash flow statement on page 26, in the year ended 31 March 2008, net cash generated from the company's operating activities was £963.7 million, compared with £867.5 million in 2006/07. The water regulator has established price increase limits to 2010, which will provide certainty for the majority of the company's turnover.

Credit ratings

During the year, the company announced that the board intends to target an investment grade credit rating of A3 for the company, which it believes best mirrors regulatory assumptions. At the year end, the company had stable long-term credit ratings of A3 and A- from Moody's Investors Service and Standard and Poor's Ratings Services respectively.

Dividend policy

The board reviewed the capital structure and dividend policy of the company in November 2007 when it approved in principle a one-off return of capital of £550.0 million as a special dividend. As a result of this special distribution, there will be a 30 per cent reduction in the 2008/09 dividend payment when compared to the 2007/08 dividend. The board expects the special dividend and revised dividend policy to increase the company's gearing level of net debt to regulatory capital value to the upper end of the Ofwat range (55 to 65 per cent for the 2005-10 price control period) and to enable it to maintain a sustainable capital structure consistent with the board's target credit rating of A3.

Liquidity

Short-term liquidity requirements are met from the company's normal operating cash flow and movements in short-term bank deposits. Further liquidity is provided by committed but undrawn credit facilities. This liquidity supports the United Utilities PLC group's US\$1.5 billion euro-commercial paper programme. The European Investment bank is currently appraising a new £400 million term loan to the company. The company also has access to the international debt capital markets through the United Utilities PLC group's €7 billion medium-term note programme, which provides for the periodic issuance of debt instruments on terms and conditions determined at the time that the instruments are issued. The programme does not represent a funding commitment, as funding is dependent on the successful issue of the debt securities. The currencies in which borrowings are held are disclosed in note 19 to the financial statements.

Debt financing and interest rate management

Long-term borrowings are structured or hedged to match earnings and assets, which are largely in sterling, indexed to UK retail price inflation and, in the case of revenues, 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 earnings and assets. At the year end, the company had in excess of £1.5 billion of such funding, representing approximately 21 per cent of the regulatory capital value of the company, with an average real interest rate of 1.8 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 34 years.

Where debt is raised in a currency other than sterling and/or with a fixed interest rate it is generally swapped to create a floating rate sterling liability for the term of the liability.

The company's interest rate management policy is to seek to match the debt service costs to regulatory cash flow which is impacted by the general interest rate environment at the time of each price determination and is then fixed for the five-year period of that price control. To hedge the exposure to each price control determination, the company enters into interest rate swaps, around the time of each price control determination, to fix interest costs for a substantial proportion of the company's debt for the duration of that price control period. Residual interest rate exposure is hedged annually, largely through the use of exchange traded financial futures contracts.

Further details of the company's borrowings and interest rate management are provided in notes 7, 19 and 20.

Treasury policy

The company's treasury function operates within the policies approved by the United Utilities PLC board. These policies are administered by the treasury committee through delegated authority from the board; it does not act as a profit centre and does not undertake any speculative trading activity.

Operating and financial review (continued)

ACCOUNTING ISSUES

The financial statements for the year ended 31 March 2008 have been prepared under the historical cost convention and in accordance with applicable UK accounting standards and, except for the treatment of certain grants and contributions (note 1 (f)), with the Companies Act 1985.

CRITICAL ACCOUNTING POLICIES

The company prepares its statutory financial statements in accordance with accounting principles generally accepted in the UK (UK GAAP). As such, the company is required to make certain estimates, judgements and assumptions that it believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the amounts of turnover and expenses during the reporting periods presented. On an ongoing basis, the company evaluates its estimates using historical experience, consultation with experts and other methods considered reasonable in the particular circumstances. Actual results may differ significantly from the estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known. The company's accounting policies are detailed in note 1 of the financial statements. The following paragraphs detail the estimates and judgements the company believes to have the most significant impact on the annual results under UK GAAP.

Carrying value of long-lived assets

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of fixed asset investment to the company, variations between actual and estimated useful lives could impact operating results both positively and negatively, although historically few changes to estimated useful lives have been required.

The company is required to evaluate the carrying values of fixed assets for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make subjective judgements concerning the cash flows, growth rates and discount rates of the cash generating units under review.

Renewals accounting

Under UK GAAP, the depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the company's asset management plan, which has been certified by Halcrow Management Sciences Limited, an independent infrastructure management consultant approved by Ofwat. Variations between actual infrastructure spend and estimated spend are included in the balance sheet, with the principle being to 'equalise' the effect of annual spend variations on the charge to the profit and loss account. Therefore, the independently certified asset management plan has an impact on the company's operating profit and changes in the plan assumptions could give rise to a different operating profit. These assumptions include judgements relating to the condition and performance of infrastructure assets.

Revenue recognition

Under UK GAAP, the company recognises revenue generally at the time of delivery and when collection of the resulting debt is reasonably assured. Should management consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned or collectibility is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred revenue.

The company raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review process.

For water and wastewater customers with water meters, the debtor billed is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. Meters are read on a cyclical basis and the company recognises revenue for unbilled amounts based on estimated usage from the last billing through to the end of the financial year.

The estimated usage is based on historic data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to the estimates is determined. For customers who do not have a meter, the debtor billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

Provision for doubtful debts

At each balance sheet date, the company evaluates the recoverability of trade debtors and records provisions for doubtful debts based on experience. These provisions are based on, amongst other things, customer category and consideration of actual collection history. The actual level of debt collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

Operating and financial review (continued)

CRITICAL ACCOUNTING POLICIES (CONTINUED)

Accounting for provisions and contingencies

The company is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses.

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, and estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. In accordance with UK GAAP, a provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made of the obligation after careful analysis of the individual matter.

The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed, unless the possibility of transferring economic benefits is remote.

Pensions

The company participates in two defined benefit schemes, one of which has a defined contribution section, which are independent of the company's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. Under UK GAAP, the pension cost under FRS 17 'Retirement benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary.

The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 21 of the financial statements. Profit before taxation and net assets are affected by the actuarial assumptions used. These assumptions include investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

Derivatives and borrowings

The company's default treatment is for borrowings to be carried at amortised cost, whilst derivatives are recognised separately on the balance sheet at fair value with movements in those fair values reflected through the profit and loss account. This has the potential to introduce considerable volatility to both the profit and loss account and balance sheet.

Therefore, where feasible, the company has taken advantage of the various provisions under FRS 26 'Financial Instruments: Recognition and Measurement' to designate borrowings at fair value through the profit and loss account to reduce this volatility and better represent the economic hedges that exist between the company's borrowings and related derivative contracts.

In order to apply hedge accounting, it must be demonstrated that the derivative has been, and will continue to be, an effective hedge of the hedged risk within the debt item. Changes in the fair value of all derivatives are recognised in the profit and loss account, except for derivatives that are designated and effective in terms of cash flow hedging relationships, in which case the gains and losses are deferred in equity.

The company applies the fair value through profit or loss option where the complexity of the swaps means that they are disallowed from being accounted for in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. This area is considered to be of significance due to the magnitude of the company's level of borrowings.

Designated borrowings and derivatives valued at fair value are valued using a discounted cash flow valuation model. This model calculates the zero coupon curves for each currency as at the balance sheet date and uses these to determine future floating cash flows. Future fixed and floating cash flows are discounted using discount factors derived from the same zero coupon curves.

The valuation of debt designated at fair value through the profit or loss incorporates an assumed credit spread in the discount factor. Credit spreads are determined based on indicative pricing data.

Cash flows denominated in foreign currencies are determined and discounted back based upon the zero coupon curve for that currency and then converted into sterling at the spot exchange rate observed at the balance sheet date.

Operating and financial review (continued)

CRITICAL ACCOUNTING POLICIES (CONTINUED)

Deferred tax

The company accounts for deferred tax on a discounted basis, as permitted by UK GAAP. The deferred tax provision under UK GAAP as at 31 March 2008 is £358.2 million (2006/07: £358.3 million). The balance sheet provision is discounted using the rates of interest at the balance sheet date on UK gilts with similar maturity dates and currencies to those of the deferred tax assets and liabilities. Therefore, the company uses 15+ years UK gilt rate to reflect the long-life nature of infrastructure and operational assets. An increase or decrease in applicable discount rates of 0.1 per cent would change the balance sheet provision at 31 March 2008 by approximately £9.0 million and the tax charge, for the year then ended, by the same amount.

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 by the company was £1.0 million in the year ended 31 March 2008 (2006/07: £1.0 million).

POST BALANCE SHEET EVENTS

The directors have recommended a final ordinary dividend for 2007/08 of £220.0 million and a special dividend of £550.0 million, subject to parent company financing being available. There were no other events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2008.

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

This report contains certain statements with respect to the financial condition, results of operations and business of the company. Some of these statements are not facts, including those about the board's beliefs and expectations. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential', 'reasonably possible', 'targets' and variations of these words and similar expressions reflect inherent risks and uncertainty. Such statements are based on current plans, estimates and projections, and therefore investors should not rely on them. Further, the company undertakes no obligation to update publicly any of them in light of new information or future events and they are relevant only as at the date made.

The company cautions investors that a number of important factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statements. These factors include: (i) the effect of, and changes in, regulation and government policy; (ii) the effects of competition and price pressures; (iii) the ability of the company to achieve cost savings and operational synergies; (iv) the ability of the company to service its future operations and capital requirements; (v) the timely development and acceptance of new products and services by the company; (vi) the effect of technological changes; and (vii) the company's success in managing the risks of the foregoing. The company cautions that the foregoing list of important factors does not address all the factors that could cause results to differ materially.

The directors of the company advise that all the information supplied in the managing director's statement beginning on page 3 and the operating and financial review on pages 5 to 20 is part of the directors' report as incorporated by reference under the heading 'Business review and principal activities'. Any liability for the information is restricted to the extent prescribed in the Companies Act 2006.

Directors' report

for the year ended 31 March 2008

The directors present their report and the audited financial statements of the company for the year ended 31 March 2008.

Profit and dividends

The results for the year, set out in the profit and loss account on page 24, show that turnover for the year ended 31 March 2008 increased to £1,426.4 million, an increase of 8.2 per cent over the previous year. Profit for the year before tax was £457.5 million (2006/07: £431.0 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. This has resulted in the final ordinary dividend for the year to 31 March 2007 of £196.3 million, which was declared after 31 March 2007, being recognised in the current year financial statements.

An interim ordinary dividend of £103.0 million (2006/07: £92.1 million) was paid in February 2008. The directors have recommended a final ordinary dividend of £220 million (2006/07: £196.3 million) and a special dividend of £550 million (2006/07: £nil). The purpose of this special dividend is to enable the company to retain a credit rating of A3, which the company believes best mirrors Ofwat's assumptions in relation to capital structure.

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 2008, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of United Utilities Water PLC, 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 twelve 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 auditors satisfies the requirements of paragraph 9.2 of Condition F of the Licence, namely that "the auditors will provide such further explanation or clarification of their reports, and such further information in respect of the matters which are the subject of their reports, as the Director General may reasonably require".

Business review and principal activities

The company is a wholly owned subsidiary of United Utilities PLC and the company's principal activities are the management and operation of water and wastewater assets.

The Managing Director's statement and the Operating and Financial Review on pages 3 to 20 report on the company's activities during the year and on likely future developments. A summary of KPIs can be found in the operating and financial review.

The directors of United Utilities Water PLC advise that all the information supplied in the Managing Director's statement beginning on page 3 and the operating and financial review on pages 5 to 20 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 1985.

Principal risks

The principal risks and uncertainties are commented on within the operating and financial review beginning on page 5.

Research and development

The company is committed to developing innovative, cost-effective and practical solutions for providing high quality services and standards to its customers, and for the benefit of the wider community and the development of the business. It seeks to take, as part of this process, maximum advantage of wide-ranging expertise, abilities and facilities within the company.

Employment policies

Employees are key to achieving the company's business goals and the company is committed to improving the skills of its people. The company respects the dignity and rights of every employee, supports them in performing various roles in society and challenges prejudice and stereotyping. The company is committed to involving employees through open and regular communications about business changes to allow a free flow of information and ideas.

The company participates extensively in Business in the Community programmes, encourage wider opportunities for women and for people from ethnic minorities and it actively support employees with disabilities.

Proper attention to health and safety is an indispensable part of the company's commitment to high standards in every aspect of the business.

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 2008, the average credit period taken for trade purchases was 21 days (2006/07: 18 days).

Directors' and officers' insurance

The company maintains an appropriate level of directors' and officers' insurance whereby directors are indemnified against liabilities to third parties to the extent permitted by the Companies Act.

Directors' report (continued)

for the year ended 31 March 2008

Directors

The directors of the company during the year ended 31 March 2008 and thereafter are set out below. All were directors for the whole year except where otherwise indicated. There are no directors' interests that require disclosure under Companies Act 1985, other than those disclosed in note 5 to the financial statements.

Non-executive directors

R Bird (appointed 1 April 2008)

P G S Entwistle (resigned 31 March 2008)

B M Gray (appointed 1 April 2008)

D E Morton JP

Executive directors

J A Barnes (resigned 16 May 2008)

M Beesley (resigned 27 September 2007)

C J Brook (appointed 27 September 2007, resigned 31 March 2008)

C Cornish* (resigned 27 September 2007)

G Dixon (resigned 27 September 2007)

C H Elphick

P N Green* (appointed 1 May 2008)

B W Hurd (resigned 31 March 2008)

I J McAulay (appointed 27 September 2007)

J M Perrie (appointed 1 April 2008)

G L Sims (appointed 19 April 2007)

T P Weller*

M R Wright (appointed 27 September 2007)

Company secretary

P A Davies (appointed 1 April 2007, resigned 25 March 2008)

D P Hosker (appointed 25 March 2008)

*Director, United Utilities PLC

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. At 31 March 2008, the directors and their immediate families had various interests in United Utilities PLC shares, which are disclosed in note 5 to the financial statements. None of the directors or their immediate families had any interests in the company.

Statement of directors' responsibilities

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). The financial statements are required by law to 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 estimates that are reasonable and prudent;
- state whether applicable United Kingdom 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 proper accounting records that 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 1985. 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 United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Information given to auditors

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

- (1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (2) the director 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 auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

Independent Auditors

The board is proposing to reappoint Deloitte & Touche LLP as auditors at the forthcoming annual general meeting.

Registered address

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

Registered number: 2366678

By order of the board

J M Perrie

Director
11 July 2008

Independent auditors' report

to the members of United Utilities Water PLC

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2008 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholder's Funds, the Balance Sheet, the Cash Flow Statement and the related notes 1 to 30. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' 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 auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (United Kingdom and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Managing Director's statement and the Operating and Financial Review that is cross-referred from the business review and principal activities section of the Directors' Report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the annual report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside of the annual report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (United Kingdom and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

Manchester

United Kingdom

11 July 2008

Profit and loss account

For the year ended 31 March	Note	2008 £m	2007 £m
Turnover			
Net operating expenses (including exceptional charges of £4.5 million (2007: £22.0 million))	1(c), 2 3	1,426.4 (775.3)	1,318.2 (749.5)
Operating profit		651.1	568.7
Net interest payable and similar charges	7	(193.6)	(137.7)
Profit on ordinary activities before taxation		457.5	431.0
Taxation on profit on ordinary activities	8	(93.1)	(97.2)
Profit for the financial year	23	364.4	333.8

The above results for the current and preceding financial year relate to continuing operations.

Statement of total recognised gains and losses

For the year ended 31 March	Note	2008 £m	2007 £m
Profit for the financial year		364.4	333.8
Actuarial (losses)/gains on defined benefit pension schemes	21, 23	(74.7)	44.6
Deferred tax attributable to actuarial losses/(gains)	17, 23	20.9	(13.4)
Total recognised gains and losses since last annual report and financial statements		310.6	365.0

Reconciliation of movements in shareholder's funds

For the year ended 31 March	Note	2008 £m	2007 £m
Profit for the financial year	23	364.4	333.8
Dividends	9, 23	(299.3)	(270.3)
Actuarial (losses)/gains on defined benefit pension schemes net of deferred tax		(53.8)	31.2
Net addition to shareholder's funds		11.3	94.7
Opening shareholder's funds		2,613.6	2,518.9
Closing shareholder's funds	23	2,624.9	2,613.6

Balance sheet

As at 31 March	Note	2008 £m	2007 £m
Fixed assets			
Tangible assets	10	7,178.9	6,692.2
Investments	11	0.2	0.3
		7,179.1	6,692.5
Current assets			
Stock: raw materials and consumables		3.4	3.9
Debtors: amounts falling due within one year	12a	888.4	294.0
Debtors: amounts falling due after more than one year	12b	44.3	13.1
Current asset investments	13	-	1,307.0
		936.1	1,618.0
Creditors: amounts falling due within one year			
Trade and other creditors	14a	(517.1)	(455.1)
Borrowings	14b	(971.6)	(1,116.7)
		(1,488.7)	(1,571.8)
Net current (liabilities)/assets		(552.6)	46.2
Total assets less current liabilities		6,626.5	6,738.7
Creditors: amounts falling due after more than one year			
Trade and other creditors	15a	(111.6)	(162.8)
Borrowings	15b	(3,473.3)	(3,605.4)
		(3,584.9)	(3,768.2)
Provisions for liabilities	17	(368.1)	(368.7)
Net assets excluding pension (liability)/asset		2,673.5	2,601.8
Pension (liability)/asset	21	(48.6)	11.8
Net assets including pension (liability)/asset		2,624.9	2,613.6
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	951.8	940.5
Equity shareholder's funds		2,624.9	2,613.6

Approved by the board of directors on 11 July 2008 and signed on its behalf by

J M Perrie
Director

Cash flow statement

For the year ended 31 March	Note	2008 £m	2007 £m
Net cash inflow from operating activities	25	963.7	867.5
Returns on investments and servicing of finance			
Interest received		62.4	58.7
Interest paid		(239.2)	(224.3)
Interest element of finance lease repayments		(2.4)	(2.9)
Non-equity dividends paid		(4.6)	(9.1)
Net cash outflow from returns on investment and servicing of finance		(183.8)	(177.6)
Taxation		(84.2)	(54.0)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(753.3)	(561.0)
Grants and contributions received	10	17.1	19.1
Disposal of tangible fixed assets		14.9	4.2
Net cash outflow for capital expenditure and financial investment		(721.3)	(537.7)
Equity dividends paid	9	(299.3)	(270.3)
Cash outflow before management of liquid resources and financing		(324.9)	(172.1)
Management of liquid resources			
Decrease/(increase) in short-term deposits		1,307.0	(569.0)
Financing	27	(1,044.6)	734.7
Decrease in cash and overdrafts in the year		(62.5)	(6.4)

Notes to the financial statements

1 Accounting policies

The following accounting policies have been applied consistently in respect of the current and prior years in dealing with items which are considered material in relation to the company's financial statements.

(a) Basis of preparation of financial statements

The financial statements of United Utilities Water PLC have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and, except for the treatment of certain grants and contributions (note (f)), with the Companies Act 1985.

The preparation of financial statements in conformity with generally accepted accounting principles in the United Kingdom requires management to make estimates and assumptions that affect the:

- reported amounts of assets and liabilities;
- disclosure of contingent assets and liabilities at the date of the financial statements; and
- reported amounts of turnover and expenses during the financial year.

Actual results could differ from these estimates.

FRS 29 (IFRS 7) 'Financial Instruments: Disclosures' has been adopted in the year. The adoption of this standard has resulted in changes in disclosure only and there was no effect on the carrying amounts of the balances in the financial statements.

(b) Cash

In the cash flow statement and related notes, cash includes cash at bank, deposits repayable on demand and overdrafts. Deposits are repayable on demand if they are, in practice, available within 24 hours without penalty.

(c) Turnover

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

(d) Research and development

Expenditure on research and development is expensed as incurred.

(e) 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 incurred in implementing the capital schemes of the company are capitalised within fixed assets.

(i) Infrastructure assets

Infrastructure assets comprise a network of water and wastewater systems. 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. Repairs to infrastructure assets are treated as operating expenditure.

Additions are included at cost after deducting related grants and contributions. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the company's independently certified asset management plan covering a five year period.

(ii) Other assets

Additions are included at cost. Freehold land is not depreciated. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated economic lives based on management's judgement and experience, which are principally as follows:

- Buildings 30-60 years
- Operational assets 5-80 years
- Fixtures, fittings, tools and equipment 3-40 years
- Computer software 3-10 years

(iii) 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.

(f) Grants and contributions

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with Schedule 4 to the Companies Act 1985 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 life of the corresponding assets.

The directors are of the opinion that, although provision is made for depreciation of infrastructure assets (see note 1(e) (i)), these assets do not have determinable finite economic lives and the capital contributions would therefore remain in the balance sheet in perpetuity. The treatment otherwise required by the Companies Act 1985 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.

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 lives of the corresponding assets.

(g) 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.

(i) Finance leases

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. Where the lease is of a fixed interest rate nature, the finance element is charged to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Where the lease is of a floating interest rate nature, the finance element charged to the profit and loss account reflects the floating interest rate charge incurred during the period on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

(ii) Operating leases

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

Notes to the financial statements (continued)

(h) Fixed asset investments

Fixed asset investments are stated at the lower of cost and recoverable amount.

(i) Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(j) Current asset investments

Current asset investments are stated at the lower of cost and net realisable value.

(k) 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 of the Electricity Supply Pension Scheme (ESPS). UUPS has both a defined benefit section and a defined contribution section, the defined contribution section constituting less than 0.9 per cent of the total asset value of UUPS. ESPS is a 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. The pension schemes are independent of the company's finances.

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 the advice of the actuaries 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.

Defined benefit assets are measured at fair value whilst liabilities are measured at present value. The difference between the two amounts is recognised as an asset or liability in the balance sheet.

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

The actuarial assumptions adopted are determined by United Utilities PLC after taking advice from their actuarial advisors, Mercer Human Resource Consulting 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 United Utilities group also operates defined contribution pension schemes. Payments are charged 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.

(l) 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 a party to the contractual provisions of the instrument.

(i) Cash and short-term deposits

Cash and short-term deposits include cash at bank and in hand, deposits and other short-term highly liquid investments which are readily convertible into known amounts of cash, have a maturity of three months or less from the date of acquisition and which are subject to an insignificant risk of change in value. In the cash flow statement and related notes, cash is stated net of bank overdrafts.

(ii) Financial investments

Investments are initially measured at fair value, including transaction costs. Investments are classified as available-for-sale and 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.

(iii) Trade debtors and trade creditors

Trade debtors are measured on initial recognition 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 are initially measured at fair value and are subsequently measured at amortised cost.

(iv) 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.

(v) Equity instruments

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

(vi) 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.

(vii) Derivative financial instruments and hedge accounting

Interest rate swap agreements and financial futures are used to manage interest rate exposure, while the company enters into cross-currency swaps to manage its exposure to fluctuations in foreign exchange rates. The company does not use derivative financial instruments for speculative purposes. All financial derivatives are recognised in the balance sheet at fair value. Changes in the fair value of all derivative financial instruments are recognised in the profit and loss account within net interest payable as they arise, except for derivatives that are designated and effective in terms of cash flow hedging relationships, in which case the gains and losses are deferred in equity.

Notes to the financial statements (continued)

(l) Financial instruments (continued)

(viii) Fair value hedges

For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in profit or loss. Gains or losses from remeasuring the derivative are recognised in profit or loss.

Where changes in the fair value of a derivative differ from changes in the fair value of the hedged item attributable to the risks being hedged, the hedge ineffectiveness is recorded in the profit and loss account within net interest payable. Hedge accounting is discontinued prospectively when the hedging instrument is sold, terminated or exercised, where the hedge relationship no longer meets the criteria for hedge accounting in accordance with FRS 26 'Financial Instruments: Recognition and Measurement', or where the hedge designation is revoked.

Any adjustment that has been recognised to the hedged item, for which the effective interest rate is used, is amortised to the profit and loss account and is based on the recalculated effective interest rate at the time at which amortisation commences.

(ix) Cash flow hedges

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the profit and loss account within net interest payable. Hedge accounting is discontinued when the hedge designation is revoked, or the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting.

At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

(x) Financial assets and liabilities designated at fair value through profit or loss

Borrowings are designated at fair value through profit or loss at inception where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. The otherwise inconsistent accounting treatment that would have resulted allows the company to satisfy the criteria for this designation.

Financial liabilities at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised incorporates any interest paid on the financial liability. The treatment of financial liabilities designated at fair value through profit or loss is consistent with the company's documented risk management strategy. Where applicable, hedge accounting will be applied.

(xi) Bank borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis to the profit and loss account using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise. In some cases, borrowings are designated at fair value through profit or loss.

(m) Environmental remediation

Environmental expenditure that relates to current or future turnover is expensed or capitalised as appropriate. 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 costs are recognised when there is a legal or constructive obligation, environmental assessments indicate clean-ups are probable, and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites.

(n) Taxation

Current tax, primarily UK corporation 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.

Notes to the financial statements (continued)

2 Segmental information

The company operated in the United Kingdom in one class of business as stated in the directors' report.

3 Net operating expenses

Profit on ordinary activities before taxation is stated after charging/(crediting):

	Note	2008 £m	2007 £m
Employee costs			
Wages and salaries		128.1	115.1
Social security costs		10.1	9.5
Pension costs		25.6	23.5
		163.8	148.1
Less charged to capital schemes		(64.7)	(55.8)
Charged to profit and loss account		99.1	92.3
Depreciation			
Owned non-infrastructure fixed assets		203.5	187.1
Non-infrastructure fixed assets held under finance leases	10	1.7	1.9
		205.2	189.0
Non-infrastructure depreciation			
Infrastructure depreciation	10	106.5	105.2
Total depreciation	10	311.7	294.2
		36.7	32.5
Raw materials and consumables			
Other operating expenses			
Hired and contracted services		135.8	91.3
Power		42.0	48.4
Property rates		59.6	54.6
Charge for bad and doubtful debts	12c	49.7	38.8
Other operating expenses		43.4	81.5
Auditors' remuneration		0.4	0.4
Amortisation of grants and contributions	16	(5.9)	(5.5)
Research and development		1.0	1.0
Operating leases			
- plant and machinery		0.7	0.8
- land and buildings		2.2	1.7
Exceptional charges – restructuring costs		4.5	13.5
– Ofwat penalty		-	8.5
Other income	4	(5.6)	(4.5)
		327.8	330.5
Total net operating expenses		775.3	749.5

Managed service fees and asset charges from parent and fellow subsidiary undertakings are contained within other operating costs. Fees payable to Deloitte & Touche LLP for non-audit services during the year were £0.2 million, primarily relating to regulatory work (2007: £0.2 million). The Deloitte & Touche LLP fee for audit services for 2007/08 amounted to £0.2 million (2007: £0.2 million).

Employee costs including business restructuring exceptional items, net of charges to capital schemes, amount to £103.6 million (2007: £98.2 million). Exceptional restructuring costs include £4.5 million (2007: £5.9 million) in respect of staff severance costs. The exceptional charge for the Ofwat penalty in the prior year related to breaches of intra-group trading rules.

Notes to the financial statements (continued)

4 Other income

	Note	2008 £m	2007 £m
Profit on disposal of tangible fixed assets	25	5.5	3.5
Rents receivable		0.1	1.0
Other income	3	<u>5.6</u>	<u>4.5</u>

5 Directors

The aggregate emoluments of the directors in 2008 amounted to £1,736,730 in respect of services allocated to the company (2007: £1,779,174). Emoluments comprise salaries, fees, taxable benefits and the value of short-term incentive awards. In addition, the company made contributions to the pension schemes of £253,163 on behalf of the directors (2007: £295,166). The emoluments of the highest paid director, B W Hurd, in respect of services allocated to the company amounted to £314,719 (2007: £108,828). Pension contributions in respect of the highest paid director were £26,353 (2007: £11,919). The emoluments of T P Weller are not included in the aggregate directors' emoluments figures as he was remunerated by United Utilities PLC and his emoluments are not recharged to United Utilities Water PLC.

There were no directors who had incentive plans which vested during the year ended 31 March 2008. Seven directors had incentive plans which vested during the year ended 31 March 2007, with an aggregate value of £342,898.

For the directors in office as at 31 March 2008 and their families, the table below shows the interests, all of which were beneficial, in the ordinary shares and options to subscribe for ordinary shares in United Utilities PLC (details of the interests of T P Weller in United Utilities PLC are disclosed in that company's financial statements). Details of the employee Sharesave Scheme and the executive share option scheme operated by United Utilities PLC are given in that company's financial statements.

	Interest in shares at 31 March 2008			Interest in shares at 31 March 2007		
	Ordinary shares	Executive option scheme	Employee sharesave scheme	Ordinary shares	Executive option scheme	Employee sharesave scheme
J A Barnes	15,312	20,333	-	21,437	24,200	278
C J Brook	1,843	7,590	-	-	-	-
C H Elphick	23,641	-	-	22,736	-	666
P G S Entwistle	2,332	-	-	2,332	-	-

The following directors had no interests in shares at either 31 March 2008 or 31 March 2007: B W Hurd, I J McAulay, D E Morton JP, G L Sims and M R Wright.

Two directors exercised options during the year (2007: four).

With the exception of G Dixon, all executive directors are members of, and contribute to the United Utilities Pension Scheme, which is an exempt approved pension scheme with defined benefit and defined contribution sections of membership. It contains sections which are open to all eligible employees. It provides pensions and other benefits to members within HM Revenue & Customs limits. The scheme provides a pension on normal retirement at age 60 of between 1/45th and 1/60th of pensionable earnings for each completed year of service. The maximum pension is two thirds of pensionable earnings. Early retirement is possible from the age of 50 if the company agrees.

G Dixon is a member of, and contributes to, the United Utilities Group of the Electricity Supply Pension Scheme, a defined benefit scheme which provides on normal retirement at the age of 60 a pension equal to 1/80th of pensionable earnings for each completed year of service (plus 3/80ths cash). Early retirement is possible from the age of 50 if the company agrees. Benefits for executive members in the United Utilities Group of the Electricity Supply Pension Scheme are equivalent to those provided to executive members in the United Utilities Pension Scheme.

Notes to the financial statements (continued)

6 Employees

	Note	2008 Number	2007 Number
Average number of persons employed during the year			
Licensed utility operations		3,906	3,490

7 Net interest payable and similar charges

		2008 £m	2007 £m
Interest payable and similar charges			
On bank loans, overdrafts and other loans		222.3	197.7
On finance leases	19	3.2	2.9
On borrowings from parent and fellow subsidiary undertakings		16.4	23.1
Interest payable before preference share dividends and fair value adjustments		241.9	223.7
Preference share dividends		9.1	9.1
Total interest payable		251.0	232.8
Fair value losses/(gains) on debt and derivative instruments¹			
Fair value hedge relationships			
- Borrowings		155.9	(105.8)
- Designated swaps		(88.3)	81.0
		67.6	(24.8)
Held for trading derivatives – economic hedge		(78.1)	27.8
		(10.5)	3.0
Financial instruments at fair value through profit or loss			
- Borrowings designated at fair value through profit or loss ²		(6.9)	(26.3)
- Held for trading derivatives – economic hedge		(25.0)	28.6
		(31.9)	2.3
Held for trading derivatives – 2005-2010 regulatory hedge		21.0	(82.6)
Net payments on swaps and debt under fair value option		41.8	52.9
Held for trading derivatives – other ³		(0.6)	0.2
Other		-	1.8
Net fair value losses/(gains)⁴		19.8	(22.4)
Total interest payable and other similar charges		270.8	210.4
Investment income			
Interest receivable and similar income			
- Parent and fellow subsidiary undertakings		(22.7)	-
- External		(40.7)	(60.6)
Net pension interest income	21	(13.8)	(12.1)
Total investment income		(77.2)	(72.7)
Net interest payable and similar charges		193.6	137.7

Notes:

- 1 Fair value losses/(gains) include foreign exchange losses of £152.4 million (2007: £45.4 million gains), excluding those on instruments measured at fair value through profit or loss.
- 2 Includes £28.2 million gain (2007: £nil) 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 £31.9 million (2007: £53.5 million) interest on swaps and debt under fair value option.

Notes to the financial statements (continued)
8 Taxation on profit on ordinary activities
(a) Analysis of charge in the year

	2008	2007
	£m	£m
Current tax		
UK corporation tax at 30 per cent (2007: 30 per cent)	106.0	79.8
Tax on exceptional items	(1.4)	(4.0)
Prior year adjustments	(8.4)	-
Total ordinary current tax	96.2	75.8
Deferred tax		
Origination and reversal of timing differences	27.2	58.1
Decrease/(increase) in discount	63.8	(38.7)
Prior year adjustments	8.4	2.0
Adjustment in respect of the abolition of industrial building allowances	(78.3)	-
Effect of change in tax rate on opening balance	(24.2)	-
Total deferred tax (credit)/charge	(3.1)	21.4
Total tax charge on profit on ordinary activities	93.1	97.2

(b) Factors affecting current tax charge for the year

The table below reconciles the notional current tax charge at the UK corporation tax rate to the actual current charge for taxation:

	2008	2007
	£m	£m
Profit on ordinary activities before taxation	457.5	431.0
	%	%
UK corporation tax rate	30.0	30.0
Capital allowances in excess of depreciation	(5.9)	(7.7)
Prior year adjustments	(1.8)	-
Other timing differences	(0.1)	(5.7)
Net (non-taxable income)/non-deductible expenses	(1.2)	1.0
Actual current tax rate	21.0	17.6

9 Dividends

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

	2008	2007
	£m	£m
Final dividend for the year ended 31 March 2007 at 21.1p per share (2006: 19.1p per share)	196.3	178.2
Interim dividend for the year ended 31 March 2008 at 11.1p per share (2007: 9.9p per share)	103.0	92.1
	299.3	270.3

United Utilities Water PLC has increased its ordinary dividend payment to United Utilities North West PLC by 10.7 per cent to £299.3 million for the year. The dividend policy is consistent with the company's performance and the management of the economic risks of the business.

The directors have recommended a final ordinary dividend for 2007/08 of £770.0 million. This is subject to approval by the equity shareholders of the company and, hence, has not been included as a liability in these financial statements. The payment consists of a special dividend of £550.0 million to realign the capital structure of United Utilities Water PLC with Ofwat's guidelines, in addition to a final dividend of £220.0 million in respect of the year ended 31 March 2008.

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 note 7).

Notes to the financial statements (continued)

10 Tangible fixed assets

	Freehold land and buildings £m	Infrastructure Assets £m	Operational Structures £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Cost						
At 1 April 2007	199.0	4,360.3	3,977.7	511.9	600.0	9,648.9
Additions	4.3	191.2	83.1	40.7	505.6	824.9
Grants and contributions	-	(17.1)	-	-	-	(17.1)
Transfers	6.2	73.7	106.6	18.1	(204.6)	-
Disposals	(5.6)	-	(35.8)	(31.2)	-	(72.6)
At 31 March 2008	203.9	4,608.1	4,131.6	539.5	901.0	10,384.1
Depreciation						
At 1 April 2007	62.9	1,483.8	1,128.2	281.8	-	2,956.7
Charge for the year	7.7	106.5	142.0	55.5	-	311.7
Disposals	(5.3)	-	(35.7)	(22.2)	-	(63.2)
At 31 March 2008	65.3	1,590.3	1,234.5	315.1	-	3,205.2
Net book value						
At 31 March 2008	138.6	3,017.8	2,897.1	224.4	901.0	7,178.9
At 31 March 2007	136.1	2,876.5	2,849.5	230.1	600.0	6,692.2

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 (f)). As a consequence, the net book value of tangible fixed assets is £151.0 million (2007: £105.6 million) lower than it would have been had this treatment not been adopted.

Infrastructure renewals

Expenditure on asset replacements to maintain the operating capability of the water and wastewater network in accordance with defined standards of service is capitalised, and depreciation is charged based on the expenditure set out in the company's independently verified Asset Management Plan for the period 1 April 2005 to 31 March 2010, in accordance with FRS 15 'Tangible Fixed Assets'.

The amount of excess depreciation over expenditure is as follows:

	£m
Excess depreciation over expenditure at 1 April 2007	(35.3)
Expenditure on asset replacements to maintain the network in the year	120.1
Depreciation for the year	(106.5)
Excess depreciation over expenditure at 31 March 2008	(21.7)

Notes to the financial statements (continued)

10 Tangible fixed assets (continued)

Operational structures held under finance lease

Within tangible fixed assets are operational structures held under finance leases at the following amounts:

Operational structures	2008	2007
	£m	£m
Cost at 31 March	81.0	81.0
Accumulated depreciation at 31 March	(16.7)	(15.0)
Net book value at 31 March	64.3	66.0

The depreciation charge for the year for assets held under finance leases is £1.7 million (2007: £1.9 million).

Capital commitments	2008	2007
Contracted but not provided for	£m	£m
	484.5	273.4

11 Fixed asset investments

	Other investments
	£m
Cost at 1 April 2007	0.3
Write-off of investments in loan notes	(0.1)
Cost at 31 March 2008	0.2

Details of other investments, all of which are unlisted, 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 each	14.09%	Water and wastewater research
	8 per cent convertible unsecured loan stock 2014	26.54%	
Paypoint Network Limited	Ordinary shares of 1 pence each	0.05%	Cash collection service
	Deferred shares of 1 pence each	0.06%	
Lingley Mere Management Company Limited	Ordinary shares of £1 each	93.27%	Estate management

The company also has an interest in Rivington Heritage Trust and Rossendale Groundwork Trust Limited both of which are limited by guarantee. Consolidated financial statements have not been prepared as both the results and the net assets of all of the company's subsidiaries are not material in the overall context of United Utilities Water PLC.

Notes to the financial statements (continued)

12 Debtors

(a) Amounts falling due within one year

	Note	2008 £m	2007 £m
Net trade debtors		94.0	81.0
Amounts owed by parent and fellow subsidiary undertakings:			
- trading balances		30.3	13.6
- fixed rate loans		497.5	-
- floating rate loans		40.6	40.6
Other debtors		14.2	11.0
Prepayments and accrued income		114.7	110.1
Current derivative financial instruments	20	97.1	37.7
		888.4	294.0

The fixed rate loans owed by fellow subsidiary undertakings of £497.5 million principally relate to a new inter-company funding structure set up during the year.

(b) Amounts falling due after more than one year

	Note	2008 £m	2007 £m
Non-current derivative financial instruments	20	44.3	13.1

(c) Allowance for bad and doubtful debts

	2008 £m	2007 £m
At beginning of the year	(138.6)	(132.4)
Amounts charged to operating expenses	(49.7)	(38.9)
Trade debtors written-off	29.3	32.7
At 31 March	(159.0)	(138.6)

(d) Ageing of gross debtors

	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2008				
Gross trade debtors	106.5	47.6	98.9	253.0
Amounts owed by parent and fellow subsidiary undertakings	568.4	-	-	568.4
Other debtors	14.2	-	-	14.2
Prepayments and accrued income	114.7	-	-	114.7
	803.8	47.6	98.9	950.3
At 31 March 2007				
Gross trade debtors	90.2	45.8	83.6	219.6
Amounts owed by parent and fellow subsidiary undertakings	54.2	-	-	54.2
Other debtors	11.0	-	-	11.0
Prepayments and accrued income	110.1	-	-	110.1
	265.5	45.8	83.6	394.9

The above analysis in respect of gross trade debtors reconciles to net trade debtors by deduction of the allowance for doubtful debtors of £159.0 million (2007: £138.6 million). The company manages its bad debt risk by providing against gross trade debtors. This allowance is calculated by reference to customer categories rather than on the age profile of gross debtor balances. It is therefore not possible to age the allowance for doubtful debtors.

United Utilities Water PLC

12 Debtors (continued)

(e) Analysis of net trade and sundry debtors by category

	2008 £m	2007 £m
Debtors in respect of unmetered water supplies	74.4	65.0
Debtors in respect of metered water supplies	100.5	87.2
Sundry debtors	48.0	49.9
	222.9	202.1

The directors consider that the carrying amount of trade and other debtors approximates to their fair value, at both 31 March 2008 and 31 March 2007.

13 Current asset investments

	2008 £m	2007 £m
Short-term deposits	-	1,307.0

Short-term deposits have been replaced in part by additional fixed rate loans owed by fellow subsidiary undertakings of £497.5 million (see note 12a).

14 Creditors: amounts falling due within one year

(a) Trade and other creditors

	Note	2008 £m	2007 £m
Trade creditors		26.0	15.7
Amounts owed to parent and fellow subsidiary undertakings		25.4	5.8
Taxation and social security		72.8	60.5
Deferred grants and contributions	16	6.2	5.4
Accruals and deferred income		361.6	319.4
Current derivative financial instruments	20	25.1	48.3
		517.1	455.1

(b) Borrowings

	2008 £m	2007 £m
Bonds, bank and other term borrowings	478.4	941.8
130,000,000 7.0 per cent £1 redeemable preference shares	130.0	130.0
Bank overdrafts	88.4	25.9
Finance lease obligations	12.6	12.0
Amounts owed to parent and fellow subsidiary undertakings	262.2	7.0
	971.6	1,116.7

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.

Notes to the financial statements (continued)

15 Creditors: amounts falling due after more than one year

(a) Trade and other creditors

	Note	2008 £m	2007 £m
Other creditors		3.4	3.4
Deferred grants and contributions	16	86.0	87.3
Non-current derivative financial instruments	20	22.2	72.1
		111.6	162.8

(b) Borrowings

		2008 £m	2007 £m
Bonds, bank and other term borrowings		3,002.8	3,093.6
Finance lease obligations		56.3	63.1
Amounts owed to parent and fellow subsidiary undertakings		414.2	448.7
		3,473.3	3,605.4

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

16 Deferred grants and contributions

	Note	2008 £m	2007 £m
At beginning of the year		92.7	88.8
Received in the year		5.4	9.4
Credited to the profit and loss account	25	(5.9)	(5.5)
At 31 March		92.2	92.7
Represented by:			
Amounts falling due within one year	14a	6.2	5.4
Amounts falling due after one year	15a	86.0	87.3
At 31 March		92.2	92.7

Notes to the financial statements (continued)

17 Provisions for liabilities

	Deferred tax: pension (note 21) £m	Deferred tax: other (note 18) £m	Other £m	Total £m
At 1 April 2007	-	358.3	10.4	368.7
At 1 April 2007 - disclosed separately in pensions note 21	5.0	-	-	5.0
Net profit and loss (credit)/charge	(2.7)	23.8	5.1	26.2
Change in taxation rate	(0.3)	(23.9)	-	(24.2)
Total movement on profit and loss account	(3.0)	(0.1)	5.1	2.0
Actuarial losses on defined benefit pension schemes Utilised in the year	(20.9)	-	-	(20.9)
	-	-	(5.6)	(5.6)
At 31 March 2008 - disclosed separately in pensions note 21	18.9	-	-	18.9
At 31 March 2008	-	358.2	9.9	368.1

Other provisions include legal claims of £9.2 million (2007: £9.2 million). The timing of the settlement of these legal claims is uncertain but expected to occur within twelve months of the balance sheet date. Other provisions also include obligations for restructuring costs which are expected to be incurred within the next twelve months.

18 Deferred tax

Deferred tax is provided as follows:

	Note	2008 £m	2007 £m
Accelerated capital allowances		1,072.9	1,191.3
Short-term timing differences		(17.5)	(17.6)
Undiscounted provision for deferred tax		1,055.4	1,173.7
Discount		(697.2)	(815.4)
Discounted provision for deferred tax	17	358.2	358.3

19 Borrowings

The following analysis provides information about the contractual terms of the company's borrowings. For more information about the company's exposure to interest rate and foreign exchange risk see note 20.

	2008 £m	2007 £m
Non-current liabilities		
Bank and other term borrowings	502.0	236.0
Bonds	2,500.8	2,857.6
Finance lease obligations	56.3	63.1
Amounts owed to parent and fellow subsidiary undertakings	414.2	448.7
	3,473.3	3,605.4
Current liabilities		
Bank overdrafts	88.4	25.9
Bank and other term borrowings	5.2	258.2
Preference shares	130.0	130.0
Bonds	473.2	683.6
Finance lease obligations	12.6	12.0
Amounts owed to parent and fellow subsidiary undertakings	262.2	7.0
	971.6	1,116.7
	4,444.9	4,722.1

Notes to the financial statements (continued)

19 Borrowings (continued)

Terms and debt repayment schedule

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

	Currency	Year of maturity	Fair value £m	2008 Carrying value £m	Fair value £m	2007 Carrying value £m
Borrowings in fair value hedge relationships						
5.625% 300m bond	GBP	2027	281.0	301.1	309.0	295.9
5% 200m bond	GBP	2035	171.4	191.6	191.9	188.4
5.25% 150m bond	GBP	2010	150.5	148.5	149.0	145.8
5.375% 150m bond	GBP	2018	149.0	147.4	152.7	142.9
4.875% 600m bond	EUR	2009	479.0	473.2	412.2	403.4
4.25% 500m bond	EUR	2020	345.7	373.4	320.7	321.7
6.625% 1,000m bond	EUR	2007	-	-	705.9	673.8
0.44% + HIBOR (floating) 150m bond	HKD	2007	-	-	9.8	9.8
5.02% JPY 10,000m dual currency loan	JPY/USD	2029	56.6	62.2	51.4	53.9
Borrowings designated at fair value through profit or loss						
6.875% 400m bond (owed to parent undertaking)	USD	2028	208.7	208.7	217.5	217.5
1.135% 3,000m bond	JPY	2013	14.4	14.4	12.5	12.5
Borrowings measured at amortised cost						
Amounts owed to parent and fellow subsidiary undertakings	GBP	Various	467.7	467.7	238.2	238.2
1.97% + RPI 200m IL loan	GBP	2016	194.1	209.0	198.6	200.7
Long term bank borrowings- floating	GBP	2007-2012	200.0	200.0	254.4	253.0
Preference shares	GBP	2099	130.0	130.0	130.0	130.0
1.9799% + RPI 100m IL bond	GBP	2035	102.3	108.7	107.3	104.7
1.7829% + RPI 100m IL bond	GBP	2040	95.3	107.6	101.5	103.6
1.5802% + RPI 100m IL bond	GBP	2042	88.9	107.2	94.5	103.3
1.847% + RPI 100m IL bond	GBP	2056	83.4	106.7	99.7	102.5
1.815% + RPI 100m IL bond	GBP	2056	82.4	106.2	102.5	102.1
1.662% + RPI 100m IL bond	GBP	2056	78.0	106.0	93.5	101.9
1.585% + RPI 100m IL bond	GBP	2057	75.7	102.0	-	-
3.375% + RPI 50m IL bond	GBP	2032	71.3	57.6	75.2	55.4
1.3258% + RPI 50m IL bond	GBP	2041	41.7	53.7	44.4	51.7
1.397% + RPI 50m IL bond	GBP	2046	41.4	53.6	43.9	51.6
1.5366% + RPI 50m IL bond	GBP	2043	44.1	53.5	46.8	51.5
1.7937% + RPI 50m IL bond	GBP	2049	46.4	53.4	48.9	51.4
1.5865% + RPI 50m IL bond	GBP	2056	37.9	53.0	45.5	50.9
1.556% + RPI 50m IL bond	GBP	2056	37.7	52.7	45.3	50.6
1.435% + RPI 50m IL bond	GBP	2056	35.9	52.5	43.3	50.5
1.702% + RPI 50m IL bond	GBP	2057	39.6	51.4	-	-
1.3805% + RPI 35m IL bond	GBP	2056	24.6	36.8	29.7	35.3
1.66% +RPI 35m IL bond	GBP	2037	30.1	35.4	-	-
Commission for the New Towns loan	GBP	2053	48.6	31.0	53.2	31.2
1.591% + RPI 25m IL bond	GBP	2056	18.9	26.4	22.8	25.4
Long term bank borrowings - fixed	GBP	2007-2008	5.1	5.0	216.5	210.0
Other borrowings						
Bank overdrafts	GBP	2008	88.4	88.4	25.9	25.9
Finance lease obligations	GBP	2014	68.9	68.9	75.1	75.1
			4,134.7	4,444.9	4,769.3	4,722.1

The amount of unamortised bond discount contained within the company's borrowings amounts to £18.4 million (2007: £22.5 million).

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

Notes to the financial statements (continued)

19 Borrowings (continued)

Notes:

Base interest rates

HIBOR Hong Kong Inter-Bank Offered Rate

Currency

GBP Pound Sterling
 EUR Euro
 HKD Hong Kong Dollar
 USD United States Dollar
 JPY Japanese Yen

Index-linked debt

IL Index-linked debt – this debt is adjusted for movements in RPI with reference to a base RPI established at the trade date.

RPI

Retail Price Index – the UK general index of retail prices (for all items) as published by the Office of National Statistics (Jan 1987 = 100) as published by HM Government.

Finance lease obligations

Finance lease obligations are payable as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2008 £m	2007 £m	2008 £m	2007 £m
Amounts payable under finance leases:				
- within one year	12.6	12.0	12.6	12.0
- in the second to fifth year inclusive	55.6	54.2	45.6	43.6
- after five years	16.0	31.8	10.7	19.5
	84.2	98.0	68.9	75.1
Less future finance charges	(15.3)	(22.9)	-	-
Present value of lease obligations	68.9	75.1	68.9	75.1
Less amounts due for settlement within 12 months			(12.6)	(12.0)
Amounts due for settlement in more than 12 months			56.3	63.1

Finance lease obligations relate to operational structures. Interest rates implicit in the minimum lease payments were fixed on completion of the assets when the primary period of the lease commenced. In addition, contingent rentals are either payable or receivable, which adjust the minimum lease payments to reflect changes in future market rates of interest. These contingent rentals are recognised as a finance income or expense in the year to which they relate. The finance expense in the year relating to contingent rentals was £2.6 million (2007: £3.4 million). The net finance charge (after adjusting for contingent rentals) for the year was £3.2 million (2007: £2.9 million) and the effective borrowing rate (after adjusting for contingent rentals) for the year was 5.05 per cent (2007: 4.26 per cent). The average lease term is six years (2007: seven years).

The minimum lease payments are also subject to adjustments for future tax charges. Any adjustment to the rentals is recognised as an increase or reduction to the future finance expense over the remaining term of the lease. The company's obligations under finance leases are unsecured.

The directors consider that the fair values of the company's lease obligations approximate to their carrying values at both 31 March 2008 and 31 March 2007.

Notes to the financial statements (continued)

20 Financial instruments

Risk management

All of the company's activities involve analysis, management and, in some cases, acceptance of risk or a combination of risks. The most important types of financial risk are credit risk, liquidity risk and market risk. Market risk includes foreign exchange, interest rate and inflation risks.

The company's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risks and limits continually by means of reliable and up-to-date systems. The company modifies and enhances its risk management policies and systems to reflect changes in markets and products. The board formulates the high level company risk management policy. The United Utilities PLC group's treasury committee is responsible for monitoring the implementation of the policy. The board has approved all of the classes of financial instruments used by the company. The United Utilities PLC group's treasury function, which is authorised to conduct the day-to-day treasury activities of the company, reports annually to the board and quarterly to the treasury committee.

The company's exposure to risk and its objectives, policies and processes for managing risk and the methods used for measuring risk have not changed since the prior year.

Credit risk

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from trade finance (the supply of services to the public and other businesses) and treasury activities (the investment of essential liquidity). The company has policies and procedures to control and monitor credit risk. The company does not believe it is exposed to any material concentrations of credit risk. 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. Due to this, the directors believe there is no further credit risk provision required in excess of the allowance for bad and doubtful debts.

The company looks to manage its risk from trade finance through the effective management of customer relationships. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply for non-payment and the limiting of a 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.

The counterparties in respect of treasury activities consist of financial institutions and other bodies considered to have good credit ratings. Although the company is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is measured and controlled through regular review of the credit ratings assigned to the counterparties by credit rating agencies, and by limiting the total amount of exposure to any one party. Management do not expect any counterparty to fail to meet its obligations, and there has not been any such failure during the year or in the preceding year.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet. At 31 March the company's maximum exposure to credit risk was as follows:

	2008	2007
	£m	£m
Cash and short-term deposits	-	1,307.0
Trade and other debtors	791.3	256.3
Derivative financial instruments	141.4	50.8
	932.7	1,614.1

Cash, short-term deposits and trade and other debtors are measured at amortised cost. Derivative financial instruments are measured at fair value.

Notes to the financial statements (continued)

20 Financial instruments (continued)

Liquidity risk

Liquidity risk is the risk that the company will not have sufficient funds to meet the obligations or commitments arising from its business operations and its financial liabilities. The company manages the liquidity profile of its assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due. The board approves a liquidity framework within which the business operates. Performance against this framework is actively monitored and reported monthly to the board using a headroom figure.

The company had available committed borrowing facilities as follows:

	2008	2007
	£m	£m
Expiring within one year	25.0	25.0
Expiring after one year but in less than two years	50.0	50.0
Expiring after more than two years	525.0	325.0
Total undrawn borrowing facilities	600.0	400.0

In addition to the committed facilities available, the company uses its euro-commercial paper programme to help manage its liquidity position.

Notes to the financial statements (continued)

20 Financial instruments (continued)

Maturity analysis

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

	Total ¹	Adjustment ²	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	£m
2008								
Bonds	8,372.0	-	589.2	234.5	72.3	76.7	79.2	7,320.1
Bank borrowings and other	898.8	-	116.0	22.6	22.7	72.1	163.3	502.1
Finance lease	84.2	-	12.6	12.9	13.5	14.3	14.9	16.0
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,283.0	-	289.0	26.8	26.8	26.8	26.8	886.8
Adjustment to carrying value	(6,323.1)	(6,323.1)	-	-	-	-	-	-
Financial liabilities excluding derivatives	4,444.9	(6,323.1)	1,136.8	296.8	135.3	189.9	284.2	8,725.0
Derivatives								
Payable	2,421.7	-	1,099.8	762.0	59.6	60.3	163.3	276.7
Receivable	(2,349.0)	-	(1,109.6)	(770.3)	(56.2)	(52.4)	(120.4)	(240.1)
Adjustment to carrying value	(166.8)	(166.8)	-	-	-	-	-	-
Derivatives	(94.1)	(166.8)	(9.8)	(8.3)	3.4	7.9	42.9	36.6
2007								
Bonds	8,101.1	-	838.9	518.4	229.0	71.9	72.7	6,370.2
Bank borrowings and other	1,111.8	-	322.2	26.7	21.6	21.8	71.2	648.3
Finance lease	98.0	-	12.0	12.5	13.2	13.9	14.6	31.8
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,128.4	-	35.6	28.5	28.5	28.5	28.5	978.8
Adjustment to carrying value	(5,847.2)	(5,847.2)	-	-	-	-	-	-
Financial liabilities excluding derivatives	4,722.1	(5,847.2)	1,338.7	586.1	292.3	136.1	187.0	8,029.1
Derivatives								
Payable	3,437.9	-	1,047.1	1,093.8	767.0	56.2	57.1	416.7
Receivable	(3,161.6)	-	(1,020.7)	(987.8)	(683.3)	(52.0)	(52.4)	(365.4)
Adjustment to carrying value	(206.7)	(206.7)	-	-	-	-	-	-
Derivatives	69.6	(206.7)	26.4	106.0	83.7	4.2	4.7	51.3

Notes:

- 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.
- 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)

20 Financial instruments (continued)

Market risk

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates and inflation will affect the company's profit. The management of market risk is undertaken with risk limits approved by the board.

The company borrows in the major global debt markets in a range of currencies at fixed and floating rates of interest, using derivatives, where appropriate, to generate the desired effective currency profile and interest basis.

The company uses a variety of financial instruments, including derivatives, when raising finance for its operations in order to manage any exposure arising from funding activity.

Interest rate risk

The company's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The company's floating rate borrowings are exposed to a risk of change in cash flows due to changes in interest rates. The company uses interest rate swap contracts and financial futures to hedge these exposures. Short-term debtors and creditors are not exposed to interest rate risk.

The company's policy is to structure debt in a way that best matches the cash flows generated by its underlying assets. As a UK regulated business, revenues are determined every five years based upon a real cost of capital. The preferred form of debt, therefore, is sterling index-linked debt. Where long-term debt is raised in a fixed rate form, the company will swap to floating rate at inception over the life of the liability, through the use of interest rate swaps.

Under an interest rate swap, the company agrees with another party to exchange at specific intervals the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. The notional principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

The company's revenues are determined based upon the real cost of capital fixed by the regulator for each five-year regulatory pricing period. The company fixes a material proportion of the floating cost of debt for the duration of the five-year regulatory pricing period, using a second layer of interest rate swaps to match the company's revenue stream.

Annually, the company enters into future contracts to hedge the remaining floating rate exposure not covered by the interest rate swaps for the current year.

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 2008 and 31 March 2007, respectively. As a result, this analysis relates to positions at the balance sheet dates and is not indicative of the years then ended, as these factors would have varied.

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

- all fair value hedge relationships are fully effective and, therefore, there is no balance sheet sensitivity to interest rates with regard to the designated debt and swaps;
- all borrowings designated at fair value through the profit and loss are effectively hedged by associated swaps and therefore there is no balance sheet sensitivity to interest rates (excluding the effect of accrued interest) with regard to the associated debt and swap instruments;
- the main balance sheet sensitivity to interest rates (excluding the effect of accrued interest) is in relation to the regulatory swaps which swap the majority of the company's floating rate exposure to fixed rate for the five-year regulatory period;
- the sensitivity of net finance expense to movements in interest rates is calculated on net floating rate exposures on debt and derivatives; and on deposits. The floating leg of a swap or any floating rate debt is treated as not having any interest rate already set, therefore a change in interest rates will have a full twelve month impact on interest;
- deposits at the balance sheet date are taken and any debt or swaps maturing during the year are disregarded;
- index-linked debt is carried at amortised cost and therefore the balance sheet is not exposed to interest rates. The company has assumed that inflation is held constant;
- financial future contracts entered into by the company to further manage the floating interest rate exposure is excluded from this analysis;
- the analysis excludes the impact of movements in market variables on the carrying value of pensions and other post retirement obligations;
- management have assessed 100 basis points as a reasonably possible movement in UK interest rate; and
- all other factors are held constant.

Notes to the financial statements (continued)

20 Financial instruments (continued)

Sensitivity analysis (continued)

	2008	2007
	£m	£m
Impact on profit before taxation and equity		
100bp increase in interest rate	17.7	83.6
100bp decrease in interest rate	(23.8)	(86.3)

Brackets denote a reduction in profit.

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 million preference shares are have been classified as more than five years according to their latest redemption date of 1 October 2009. The repricing analysis demonstrates the company's exposure to floating rate risk prior to the effect of financial futures.

2008	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	1,697.4	473.2	148.5	-	-	-	1,075.7
Effect of swaps	-	1,224.2	(148.5)	-	-	-	(1,075.7)
	1,697.4	1,697.4	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	223.1	-	-	-	-	-	223.1
Effect of swaps	-	223.1	-	-	-	-	(223.1)
	223.1	223.1	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	166.0	5.2	0.2	0.2	0.3	0.3	159.8
Floating rate instruments	825.0	825.0	-	-	-	-	-
Index-linked instruments	1,533.4	1,533.4	-	-	-	-	-
	2,524.4	2,363.6	0.2	0.2	0.3	0.3	159.8
Effect of a fixed hedge for the term of the regulatory business plan	-	(1,840.6)	1,392.2	448.4	-	-	-
Total borrowings	4,444.9	2,443.5	1,392.4	448.6	0.3	0.3	159.8
2007	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	2,225.8	673.8	403.4	145.8	-	-	1,002.8
Floating rate instruments	9.8	9.8	-	-	-	-	-
Effect of swaps	-	1,552.0	(403.4)	(145.8)	-	-	(1,002.8)
	2,235.6	2,235.6	-	-	-	-	-
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	230.0	-	-	-	-	-	230.0
Effect of swaps	-	230.0	-	-	-	-	(230.0)
	230.0	230.0	-	-	-	-	-
Borrowings measured at amortised cost							
Fixed rate instruments	371.2	205.2	5.2	0.2	0.2	0.3	160.1
Floating rate instruments	592.2	592.2	-	-	-	-	-
Index-linked instruments	1,293.1	1,293.1	-	-	-	-	-
	2,256.5	2,090.5	5.2	0.2	0.2	0.3	160.1
Effect of a fixed hedge for the term of the regulatory business plan	-	(2,938.6)	-	1,971.1	967.5	-	-
Total borrowings	4,722.1	1,617.5	5.2	1,971.3	967.7	0.3	160.1

Notes to the financial statements (continued)

20 Financial instruments (continued)

Currency risk

The company's assets are principally sterling denominated; however, the company has access to various international debt capital markets and raises foreign currency denominated debt. Where debt is denominated in a currency which is not sterling, the company's policy is generally to swap the foreign currency denominated cash flows into sterling, through the use of foreign currency swaps. As a result, for the majority of foreign currency denominated borrowings, the company has no material exposure to movements in exchange rates.

Under a currency swap, the company agrees with another party to exchange the principal amount of two currencies, together with interest amounts in the two currencies agreed by reference to a specific interest rate basis and the principal amount. The principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

As the company has no material exposure to currency risk no analysis has been presented.

Inflation risk

The company's index-linked borrowings are exposed to a risk of change in the carrying value and interest liabilities due to changes in the UK RPI. This form of liability is a good match for the company's regulated assets, which are also linked to RPI due to the revenue price cap imposed by the regulator. This price cap is linked to RPI and limits management's ability to change prices. By matching the company's liabilities to its assets, index-linked debt hedges the exposure to changes in RPI and delivers a cash flow benefit, as compensation for the inflation risk is provided through adjustment to the principal rather than in cash. Management looks to issue index-linked debt wherever possible, but has a limited counterparty base willing to invest in these instruments. The ability to issue this form of debt is therefore limited.

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

	2008	2007
	£m	£m
Index-linked debt	1,533.4	1,293.1

The below sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at the 31 March 2008 and 31 March 2007, respectively. As a result, this analysis relates to positions at the balance sheet dates 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, excluding the hedging aspect of the company's regulatory assets, which are not classed as financial assets:

	2008	2007
	£m	£m
Impact on profit before taxation and equity		
1 per cent increase in RPI	(15.7)	(14.3)
1 per cent decrease in RPI	15.7	14.3

Brackets denote a reduction in profit.

The analysis assumes a one per cent change in RPI having a corresponding one per cent impact on this position over a twelve-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 income statement are fixed and based upon either the previous three or eight month RPI.

Notes to the financial statements (continued)

20 Financial instruments (continued)

Capital risk management

The objective of the United Utilities PLC group when managing capital is to maintain a capital structure that enables the company to retain a credit rating of A3, which it believes best mirrors the Water Services Regulation Authority's ('Ofwat') assumptions in relation to capital structure.

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 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, credit investors and benefits for other stakeholders.

In order to maintain a credit rating of A3 the company will need to manage its capital structure with reference to the ratings methodology and measures used by the relevant rating agencies. The ratings methodology is normally based on a number of key ratios (such as Regulatory Capital Value (RCV) gearing and adjusted interest cover) and threshold levels as updated and published from time to time by the rating agencies.

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.

The strategy of targeting a credit rating of A3 for the company was announced as part of the United Utilities PLC group's interim results announcement in November 2007. Consistent with this strategy and in order to adjust the RCV gearing levels in line with the rating agencies tolerance levels for an A3 credit rating, the group announced that it intends to return £1.5 billion to shareholders (with a corresponding reduction in its equity base) during August 2008 and reduce its dividend per share by 30 per cent with effect from February 2009.

Notes to the financial statements (continued)

20 Financial instruments (continued)

Fair values

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

	2008	2008	2007	2007
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
Financial assets				
<i>Non-current assets</i>				
Derivative financial instruments				
Fair value hedge derivatives	44.3	44.3	13.1	13.1
<i>Current assets</i>				
Cash and short-term deposits	-	-	1,307.0	1,309.3
Trade and other debtors	791.3	791.3	256.3	256.3
Derivative financial instruments				
Held for trading derivatives	97.1	97.1	37.7	37.7
Total current assets	888.4	888.4	1,601.0	1,603.3
Financial liabilities				
<i>Non-current liabilities</i>				
Trade and other creditors	(89.4)	(89.4)	(90.7)	(90.7)
Borrowings				
Financial liabilities designated at fair value through profit or loss	(223.1)	(223.1)	(230.0)	(230.0)
Financial liabilities in a hedged relationship	(1,224.2)	(1,154.2)	(1,552.0)	(1,586.9)
Financial liabilities measured at amortised cost	(2,026.0)	(1,779.9)	(1,823.4)	(1,796.1)
	(3,473.3)	(3,157.2)	(3,605.4)	(3,613.0)
Derivative financial instruments				
Fair value hedge derivatives	(22.2)	(22.2)	(72.1)	(72.1)
Total non-current liabilities	(3,584.9)	(3,268.8)	(3,768.2)	(3,775.8)
<i>Current liabilities</i>				
Trade and other creditors	(492.0)	(492.0)	(406.8)	(406.8)
Borrowings				
Financial liabilities in a hedged relationship	(473.2)	(479.0)	(683.6)	(715.7)
Financial liabilities measured at amortised cost	(498.4)	(498.5)	(433.1)	(440.8)
	(971.6)	(977.5)	(1,116.7)	(1,156.5)
Derivative financial instruments				
Held for trading derivatives	(25.1)	(25.1)	(48.3)	(48.3)
Total current liabilities	(1,488.7)	(1,494.6)	(1,571.8)	(1,611.6)

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 upon 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 £6.9 million gain (2007: £26.3 million gain), £28.2 million gain (2007: £nil) is attributable to changes in credit risk. The cumulative impact of changes in credit spread was £30.6 million profit (2007: £2.4 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount decrease of £41.5 million (2007: a carrying amount decrease of £34.6 million).

Notes to the financial statements (continued)

21 Retirement benefits

The company participates in the following pension schemes sponsored by the United Utilities group: the United Utilities Pension Scheme (UUPS) and the United Utilities Group of the Electricity Supply Pension Scheme (ESPS). Both schemes are funded defined benefit schemes which are closed to new employees. UUPS also includes a defined contribution section, which constitutes less than 0.9 per cent of the total asset value. Under FRS 17 'Retirement benefits', the current service cost is calculated using the Projected Unit Credit Method and will therefore increase as the members of the scheme approach retirement.

The assets of these schemes are held in trust funds independent of the company's finances.

The last actuarial valuation of the UUPS was carried out as at 31 March 2007 and the ESPS was carried out as at 30 November 2007. 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 2008 by projecting forward from the dates of the respective valuations, and have been performed by an independent actuary, Mercer Human Resource Consulting.

On 31 March 2005, the company made lump sum payments of £110.9 million and £2.9 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that would have been payable for the defined benefit members over the five years from 1 April 2005. Following the results of the actuarial valuations, the company contributions are expected to resume from 1 April 2010. In the meantime, the company will continue to pay contributions in respect of the defined contribution members and insurance premiums. Other payments will be made by the company in accordance with the funding agreement between the schemes' trustees and United Utilities PLC.

The company did not make any significant contributions to the defined benefit schemes for the year ended 31 March 2008 or the year ended 31 March 2007 and does not expect to make any contributions over the year to 31 March 2009.

The total defined benefit pension expense for the year was £11.2 million (2007: £11.4 million). A pension liability of £48.6 million, net of deferred tax of £18.9 million, is included in the balance sheet at 31 March 2008 (2007: asset of £11.8 million, net of deferred tax of £5.0 million).

Information about pension arrangements for executive directors is contained in note 5.

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

	31 March 2008	31 March 2007	31 March 2006
	%	%	%
Discount rate – UUPS	6.00	5.20	4.90
Discount rate – ESPS	6.10	5.30	4.90
Expected return on assets – UUPS	6.80	6.50	6.20
Expected return on assets – ESPS	6.50	6.30	5.90
Pensionable salary growth – UUPS	4.35	3.95	3.75
Pensionable salary growth – ESPS	4.40	4.00	3.80
Pension increases	3.40	3.00	2.80
Price inflation	3.40	3.00	2.80

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

	2008	2007	2006
	years	years	years
Retired member	24.9	23.8	22.5
Non-retired member	26.0	25.9	24.8

Notes to the financial statements (continued)

21 Retirement benefits (continued)

As at 31 March the fair value of the schemes' assets, together with the liabilities in the schemes' recognised in the balance sheet, and the expected rates of return were as follows:

	Plan assets at 31 March 2008	Long-term rate of return expected at 31 March 2008	Value at 31 March 2008	Plan assets at 31 March 2007	Long-term rate of return expected at 31 March 2007	Value at 31 March 2007
	%	%	£m	%	%	£m
Equities	69.4	7.5	717.0	69.5	7.3	783.5
Gilts	16.6	4.5	171.6	16.4	4.3	184.4
Bonds	13.1	6.8	135.0	13.1	5.1	147.0
Cash	0.9	4.5	10.1	1.0	4.3	11.3
Total fair value of assets	100.0		1,033.7	100.0		1,126.2
Present value of liabilities			(1,101.2)			(1,109.4)
Pension (liability)/asset			(67.5)			16.8
Related deferred tax asset/(liability)			18.9			(5.0)
Net pension (liability)/asset			(48.6)			11.8

Details in connection with 2006 are as follows:

	Plan assets at 31 March 2006	Long-term rate of return expected at 31 March 2006 %	Value at 31 March 2006
	%		£m
Equities	66.6	7.1	746.8
Gilts	22.3	4.1	250.1
Bonds	11.0	4.9	123.4
Property	0.1	7.1	1.1
Total fair value of assets	100.0		1,121.4
Present value of liabilities			(1,138.4)
Net retirement benefit liability			(17.0)
Related deferred tax asset			5.1
Net pension liability			(11.9)

Notes to the financial statements (continued)

21 Retirement benefits (continued)

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

	2008	2007
	£m	£m
Current service cost	(22.4)	(21.3)
Past service cost	(2.6)	(2.2)
Expected return on schemes' assets	72.0	68.3
Interest on schemes' liabilities	(58.2)	(56.2)
Net pension expense before taxation	(11.2)	(11.4)

The above amounts are all recognised within operating expenses except for expected return on schemes' assets and interest on schemes' liabilities which have been recognised within net interest payable and similar charges.

The reconciliation of the opening and closing pension scheme (liability)/asset is as follows:

	2008	2007
	£m	£m
At beginning of the year	16.8	(17.0)
Expenses recognised in the profit and loss account	(11.2)	(11.4)
Contributions paid	1.6	0.6
Actuarial (losses)/gains gross of taxation	(74.7)	44.6
At 31 March	(67.5)	16.8

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses.

The history of the schemes is as follows:

	2008	2007	2006	2005
Experience gain/(loss) on schemes' liabilities (£m)	14.3	28.7	-	(2.3)
Percentage of scheme liabilities (%)	(1.3)	(2.6)	-	0.2
Difference between the expected and actual return on schemes' assets (£m)	(131.4)	(7.3)	168.3	7.2
Percentage of scheme assets (%)	(12.7)	(0.6)	15.0	0.8
Change in assumptions (£m)	42.4	23.2	(114.8)	(6.5)
Percentage of scheme liabilities (%)	(3.9)	(2.1)	10.1	0.7
Amount recognised in statement of total recognised gains and losses (£m)	(74.7)	44.6	53.5	(1.6)
Percentage of scheme liabilities (%)	(6.8)	(4.0)	(4.7)	0.2

During the year, the company made £0.6 million (2007: £nil) of contributions to defined contribution schemes, recognised within operating expenses.

Notes to the financial statements (continued)

22 Called up share capital and share premium account

	2008 £m	2007 £m
Authorised share capital		
1,050,000,000 ordinary shares of £1 each	1,050.0	1,050.0
223,437,000 zero per cent preference shares of £1 each	223.4	223.4
	<u>1,273.4</u>	<u>1,273.4</u>
Allotted and fully paid share capital		
931,930,000 ordinary shares of £1 each	931.9	931.9
93,437,000 zero per cent preference shares of £1 each	93.4	93.4
	<u>1,025.3</u>	<u>1,025.3</u>
Share premium account	<u>647.8</u>	<u>647.8</u>

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.

23 Share capital and reserves

	Note	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m
At 1 April 2007		1,025.3	647.8	940.5	2,613.6
Profit for the financial year		-	-	364.4	364.4
Actuarial losses on defined benefit pension schemes	21	-	-	(74.7)	(74.7)
Deferred tax credit arising on actuarial losses on defined benefit pension schemes		-	-	20.9	20.9
Dividends paid on equity shares	9	-	-	(299.3)	(299.3)
At 31 March 2008		<u>1,025.3</u>	<u>647.8</u>	<u>951.8</u>	<u>2,624.9</u>

24 Operating leases

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

	Land and buildings 2008 £m	Plant and machinery 2008 £m	Land and buildings 2007 £m	Plant and machinery 2007 £m
Non-cancellable operating leases which expire:				
Within one year	-	0.3	-	0.2
Between two and five years	-	0.6	-	0.7
After five years	1.0	-	1.0	-
	<u>1.0</u>	<u>0.9</u>	<u>1.0</u>	<u>0.9</u>

Notes to the financial statements (continued)

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

	Note	2008 £m	2007 £m
Operating profit		651.1	568.7
Depreciation	10	311.7	294.2
Amortisation of grants and contributions	16	(5.9)	(5.5)
Profit on disposal of tangible fixed assets	4	(5.5)	(3.5)
Decrease/(increase) in stocks		0.5	(0.7)
(Increase)/decrease in debtors		(36.5)	4.8
Increase/(decrease) in creditors		25.4	(22.2)
Movement in other provisions (including pension (liability)/asset)		22.9	31.7
Net cash inflow from operating activities		963.7	867.5

26 Reconciliation of net cash flow to movement in net debt

	Note	2008 £m	2007 £m
Decrease in cash/increase in overdrafts in the year		(62.5)	(6.4)
Net cash outflow/(inflow) from decrease/(increase) in debt and lease financing		1,044.6	(734.7)
Net cash (inflow)/outflow from (decrease)/increase in liquid resources		(1,307.0)	569.0
Changes in net debt resulting from cash flows		(324.9)	(172.1)
Non-cash adjustments		(207.4)	60.0
Movement in net debt in the year		(532.3)	(112.1)
Net debt at beginning of the year		(3,374.5)	(3,262.4)
Net debt at 31 March	28	(3,906.8)	(3,374.5)

Non-cash adjustments include fair value movements, capitalised interest and indexation.

27 Financing

	2008 £m	2007 £m
New loans	499.3	804.9
Loans repaid	(1,040.2)	(65.1)
Loans issued	(497.5)	-
	(1,038.4)	739.8
Finance lease repayments	(6.2)	(5.1)
Net cash (outflow)/inflow from financing	(1,044.6)	734.7

Notes to the financial statements (continued)

28 Analysis of changes in net debt

	At 1 April 2007 £m	Cash flow £m	Non-cash Movements £m	At 31 March 2008 £m
Overdrafts	(25.9)	(62.5)	-	(88.4)
Parent and fellow subsidiary undertaking loans	40.6	497.5	-	538.1
	14.7	435.0	-	449.7
Debt due after one year	(3,542.3)	(129.7)	255.0	(3,417.0)
Debt due within one year	(1,078.8)	670.6	(462.4)	(870.6)
Finance leases	(75.1)	6.2	-	(68.9)
	(4,696.2)	547.1	(207.4)	(4,356.5)
Current asset investments	1,307.0	(1,307.0)	-	-
Net debt	(3,374.5)	(324.9)	(207.4)	(3,906.8)

29 Related party transactions

In accordance with the exemption set out in FRS 8 'Related Party Disclosures', the company has not disclosed transactions with its ultimate holding company or any members of the United Utilities group. United Utilities PLC is the ultimate controlling party as defined by FRS 8 'Related Party Disclosures'. United Utilities PLC, the ultimate parent undertaking, owned 22.63 per cent of the shareholding of the ordinary share capital of THUS Group PLC until 19 June 2007. Details of the transactions with this company during this period are set out below.

	2008 £m	2007 £m
Sale of services	0.1	0.3
Purchase of services	0.7	2.2
Debtor outstanding	-	0.4

There were no amounts written-off related party debtors in the year (2007: £nil).

30 Ultimate parent undertaking and controlling party

The financial statements of the company are consolidated in the group financial statements of the ultimate parent undertaking, United Utilities PLC, a company registered in England and Wales. United Utilities PLC is also the company's ultimate controlling party. Copies of the financial statements of United Utilities PLC may be obtained from the Company Secretary, Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.

Regulatory accounting information

Introduction

The Regulatory Accounts on pages 59 to 76 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 Operating and financial review has been presented on pages 5 to 20.

Directors’ responsibilities in respect of the preparation of the regulatory accounts

The directors consider that all Regulatory Accounting Guidelines issued by the WSRA which they consider to be applicable to these financial statements have been followed. After making enquiries, the directors are of the opinion that the company has adequate resources to continue in operational existence for the foreseeable future.

For this reason, they continue to adopt a going concern basis in preparing these financial statements.

In addition, the directors have responsibility for ensuring that the company keeps proper accounting records sufficient to enable the historical cost and current cost information required by Condition F of the licence to be prepared, having regard to all Regulatory Accounting Guidelines. The directors are also required to confirm in the financial statements that, in their opinion, the company was in compliance with paragraph 3.1 of Condition K of the licence relating to the availability of the rights and assets at the end of the financial year.

Information given to auditors

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

- (1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (2) the director 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 auditors are aware of that information.

Independent accountants’ report

INDEPENDENT ACCOUNTANTS’ REPORT TO THE WATER SERVICES REGULATION AUTHORITY (“THE WSRA”) AND UNITED UTILITIES WATER PLC (“THE COMPANY”)

We have audited the Regulatory Accounts of the Company for the year ended 31 March 2008 on pages 59 to 76 which comprise:

- the regulatory historic cost accounting statements, comprising the historic cost profit and loss account, the statement of total historical cost recognised gains and losses for the appointed business, and the historic cost balance sheet; 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, the notes to the current cost cash flow statement and the related notes 1 to 12 including the statement of accounting policies under which the Regulatory Accounts have been prepared.

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 (the “Regulatory Licence”).

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 the company’s Instrument of Appointment 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 Company and the WSRA, for our audit work, for this report, or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the appointment and the Regulatory Accounting Guidelines (being versions 1.04, 2.03, 3.06, 4.03 and 5.04), 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. There are differences between United Kingdom Generally Accepted Accounting Practice (“UK GAAP”) and the basis of preparation of information provided in the Regulatory Accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects.

Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Independent accountants' report (continued)

Respective responsibilities of the WSRA, the Directors and auditors

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.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 56.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion', below and having regard to the guidance contained in Audit Technical Release 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, asset and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guidelines for the classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets) and whether the regulatory current cost accounting statements on pages 61 to 76 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03.

We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F of the Regulatory Licence and whether the information is in agreement with the Appointee's underlying accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06, and Regulatory Accounting Guideline 4.03.

We read the other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the Regulatory Licence.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the UK Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, 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 Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory Audit") was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985.

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 Auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory Audit work, for our Statutory Audit report, or for the opinions we have formed in respect of that Statutory Audit.

The regulatory historical cost accounting statements on pages 59 and 60 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 FRS 12 'Provisions, contingent liabilities and contingent assets' and FRS 15 'Tangible Fixed Assets' be disappplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on pages 74 and 75.

Independent accountants' report (continued)

Audit opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2008 fairly present in accordance with 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, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 64, the state of the Company's affairs at 31 March 2008 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those Conditions, Guidelines and accounting policies.

We are also required to report in respect of various specific obligations of the Company as set out in its Instrument of Appointment. In respect of these obligations, we report that in our opinion:-

(a) proper accounting records have been kept by the Appointee as required by paragraph 3 of Condition F of the instrument;

(b) the information is in agreement with the Appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;

(c) the regulatory historical cost accounting statements on pages 59 and 60 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the Appointee and its Appointed Business in accordance with the company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA; and

(d) the regulatory current cost accounting statements on pages 61 to 63 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Manchester, United Kingdom

11 July 2008

Historic cost profit and loss account

For the year ended 31 March

	Note	2008 Appointed £m	2008 Non- appointed £m	2008 Total £m	2007 Appointed £m	2007 Non- appointed £m	2007 Total £m
Turnover		1,418.2	10.1	1,428.3	1,310.0	8.2	1,318.2
Operating costs (including exceptional charges of £4.5 million (2007: £22.0 million))		(582.7)	(4.9)	(587.6)	(568.5)	(4.3)	(572.8)
Historical cost depreciation		(205.2)	-	(205.2)	(189.0)	-	(189.0)
Operating income		5.5	-	5.5	3.5	-	3.5
Operating profit		635.8	5.2	641.0	556.0	3.9	559.9
Other income	4	-	-	-	1.0	-	1.0
Net interest		(193.6)	-	(193.6)	(137.7)	-	(137.7)
Profit on ordinary activities before taxation		442.2	5.2	447.4	419.3	3.9	423.2
Current tax		(94.9)	(1.6)	(96.5)	(74.6)	(1.2)	(75.8)
Deferred tax		5.7	-	5.7	(19.0)	-	(19.0)
Taxation on profit on ordinary activities		(89.2)	(1.6)	(90.8)	(93.6)	(1.2)	(94.8)
Profit for the year		353.0	3.6	356.6	325.7	2.7	328.4
Dividends		(296.6)	(2.7)	(299.3)	(266.0)	(4.3)	(270.3)
Retained profit/(loss) for the year		56.4	0.9	57.3	59.7	(1.6)	58.1

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

For the year ended 31 March

	2008 £m	2007 £m
Profit for the year (before dividends)	353.0	325.7
Actuarial (losses)/gains on post-employment plans (net of deferred tax)	(53.8)	31.2
Total recognised gains and losses for the year	299.2	356.9

Historic cost balance sheet

At 31 March

	2008	2008	2008	2007	2007	2007
	Appointed	Non –	Total	Appointed	Non –	Total
	£m	appointed	£m	£m	appointed	£m
		£m			£m	
Fixed assets						
Tangible fixed assets	7,171.7	-	7,171.7	6,704.7	-	6,704.7
Investments - other	0.2	-	0.2	0.3	-	0.3
Total fixed assets	7,171.9	-	7,171.9	6,705.0	-	6,705.0
Current assets						
Stock	3.4	-	3.4	3.9	-	3.9
Debtors	394.0	1.4	395.4	262.7	3.8	266.5
Cash	-	-	-	-	-	-
Short-term deposits	538.1	-	538.1	1,347.6	-	1,347.6
Total current assets	935.5	1.4	936.9	1,614.2	3.8	1,618.0
Creditors: amounts falling due within one year						
Overdrafts	(88.4)	-	(88.4)	(25.9)	-	(25.9)
Infrastructure renewals accrual	(28.0)	-	(28.0)	(36.9)	-	(36.9)
Creditors	(445.3)	3.9	(441.4)	(392.0)	-	(392.0)
Borrowings	(753.2)	-	(753.2)	(960.8)	-	(960.8)
Corporation tax payable	(68.1)	(1.6)	(69.7)	(56.4)	(1.1)	(57.5)
Total creditors	(1,383.0)	2.3	(1,380.7)	(1,472.0)	(1.1)	(1,473.1)
Net current (liabilities)/assets	(447.5)	3.7	(443.8)	142.2	2.7	144.9
Total assets less current liabilities	6,724.4	3.7	6,728.1	6,847.2	2.7	6,849.9
Creditors: amounts falling due after one year						
Borrowings	(3,473.3)	-	(3,473.3)	(3,605.4)	-	(3,605.4)
Other creditors	(25.5)	-	(25.5)	(75.6)	-	(75.6)
Total creditors	(3,498.8)	-	(3,498.8)	(3,681.0)	-	(3,681.0)
Provisions for liabilities and charges						
Deferred tax provision	(348.3)	-	(348.3)	(350.9)	-	(350.9)
Other provisions	(9.9)	-	(9.9)	(10.4)	-	(10.4)
Deferred income – grants and contributions	(92.2)	-	(92.2)	(92.7)	-	(92.7)
Post employment (liabilities)/assets	(48.6)	-	(48.6)	11.8	-	11.8
Preference share capital	(130.0)	-	(130.0)	(130.0)	-	(130.0)
Net assets employed	2,596.6	3.7	2,600.3	2,594.0	2.7	2,596.7
Capital and reserves						
Called up equity share capital	1,025.4	-	1,025.4	1,025.4	-	1,025.4
Share premium	647.8	-	647.8	647.8	-	647.8
Profit and loss account	923.4	3.7	927.1	920.8	2.7	923.5
Capital and reserves	2,596.6	3.7	2,600.3	2,594.0	2.7	2,596.7

Details of reconciling items between the historic 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	Note	2008 £m	2007 £m
Turnover	2	1,418.2	1,310.0
Current cost operating costs (including exceptional charges of £4.5 million (2007 – £22.0 million))	3	(899.4)	(862.8)
Operating income	2	4.1	3.4
		<hr/>	
		522.9	450.6
Working capital adjustment	2	2.1	6.7
		<hr/>	
Current cost operating profit		525.0	457.3
Other income	4	-	1.0
Net interest		(193.6)	(137.7)
Financing adjustment		48.0	180.9
		<hr/>	
Current cost profit on ordinary activities before taxation		379.4	501.5
Current tax		(94.9)	(74.6)
Deferred tax		5.7	(19.0)
		<hr/>	
Taxation on current cost profit on ordinary activities		(89.2)	(93.6)
		<hr/>	
Current cost profit attributable to shareholders		290.2	407.9
Dividends		(296.6)	(266.0)
		<hr/>	
Current cost (loss)/profit retained		(6.4)	141.9

Current cost balance sheet for the appointed business

At 31 March

	Note	2008 £m	2007 £m
Fixed assets			
Tangible assets	5	45,881.2	43,838.4
Third party contributions since 1989/90		(364.0)	(314.9)
		45,517.2	43,523.5
Working capital			
Working capital	7	(148.1)	(92.1)
Short-term deposits		538.1	1,347.6
Overdrafts		(88.4)	(25.9)
Infrastructure renewals accrual		(28.0)	(36.9)
		45,790.8	44,716.2
Net operating assets			
Non-operating assets and liabilities			
Borrowings		(753.2)	(960.8)
Non-trade debtors		159.1	64.3
Non-trade creditors		(58.9)	(97.7)
Investments – other		0.2	0.3
Corporation tax payable		(68.1)	(56.4)
		(720.9)	(1,050.3)
Total non-operating assets and liabilities			
Creditors: amounts falling due after more than one year			
Borrowings		(3,473.3)	(3,605.4)
Other creditors		(25.5)	(75.6)
		(3,498.8)	(3,681.0)
Total creditors falling due after more than one year			
Provisions for liabilities and charges			
Deferred tax provision		(348.3)	(350.9)
Post-employment (liabilities)/assets		(48.6)	11.8
Other provisions		(9.9)	(10.4)
		(406.8)	(349.5)
Total provisions			
Preference share capital		(130.0)	(130.0)
		41,034.3	39,505.4
Net assets			
Capital and reserves			
Called up equity share capital		1,025.4	1,025.4
Share premium		647.8	647.8
Profit and loss account		(147.5)	(87.3)
Current cost reserve	8	39,508.6	37,919.5
		41,034.3	39,505.4
Total capital and reserves			

Current cost cash flow statement

For the year ended 31 March

	2008 Appointed £m	2008 Non- appointed £m	2008 Total £m	2007 Appointed £m	2007 Non- appointed £m	2007 Total £m
Current cost operating profit	525.0	3.9	528.9	457.3	3.9	461.2
Working capital adjustment	(2.1)	-	(2.1)	(6.7)	-	(6.7)
(Increase)/decrease in working capital	(6.3)	-	(6.3)	(17.9)	0.4	(17.5)
Receipts from other income	-	-	-	1.0	-	1.0
Current cost depreciation (net of amortisation of deferred contributions)	305.6	-	305.6	285.5	-	285.5
Current cost profit on sale of fixed assets	(4.1)	-	(4.1)	(3.4)	-	(3.4)
Infrastructure renewals charge	117.4	-	117.4	113.0	-	113.0
Other non-cash profit and loss items	22.7	-	22.7	34.4	-	34.4
Net cash inflow from operating activities	958.2	3.9	962.1	863.2	4.3	867.5
Returns on investments and servicing of finance						
Interest received	62.4	-	62.4	58.7	-	58.7
Interest paid	(239.1)	-	(239.1)	(224.3)	-	(224.3)
Interest in finance lease rentals	(2.4)	-	(2.4)	(2.9)	-	(2.9)
Non-equity dividends paid	(4.6)	-	(4.6)	(9.1)	-	(9.1)
Net cash outflow from returns on investments and servicing of finance	(183.7)	-	(183.7)	(177.6)	-	(177.6)
Taxation paid	(83.0)	(1.2)	(84.2)	(54.0)	-	(54.0)
Capital expenditure						
Gross cost of purchase of fixed assets	(627.0)	-	(627.0)	(456.1)	-	(456.1)
Receipt of grants and contributions	19.0	-	19.0	19.1	-	19.1
Infrastructure renewals expenditure	(126.3)	-	(126.3)	(104.9)	-	(104.9)
Disposal of fixed assets	14.5	-	14.5	4.2	-	4.2
Net cash outflow from investing activities	(719.8)	-	(719.8)	(537.7)	-	(537.7)
Equity dividends paid	(296.6)	(2.7)	(299.3)	(266.0)	(4.3)	(270.3)
Management of liquid resources						
Net cash inflow/(outflow) from management of liquid resources	809.5	-	809.5	(569.0)	-	(569.0)
Net cash inflow/(outflow) before financing	484.6	-	484.6	(741.1)	-	(741.1)
Financing						
New bank loans	499.3	-	499.3	804.9	-	804.9
Repayment of bank loans	(1,040.2)	-	(1,040.2)	(65.1)	-	(65.1)
Capital element in finance lease rentals	(6.2)	-	(6.2)	(5.1)	-	(5.1)
Net cash (outflow)/inflow from financing	(547.1)	-	(547.1)	734.7	-	734.7
Decrease in cash/increase in overdrafts	(62.5)	-	(62.5)	(6.4)	-	(6.4)

Notes to the current cost accounts

1 Statement of 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 policies adopted, which have been applied consistently during the year and the prior year, as set out below:

(a) 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.

The modern equivalent asset values from the last Asset Management Plan (AMP) are incorporated in the 2008 regulatory accounting information. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the Retail Price Index (RPI).

(i) Operational assets

Non-specialised operational assets are valued on the basis of open market value for existing use and have been 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).

(ii) 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.

(iii) Other fixed assets

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

(iv) 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.

(b) 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.

(c) 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.

(i) 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.

(ii) 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.

(d) 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.

(e) 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.

(f) 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 company is not a monopoly supplier or the activity involves 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 upon activities undertaken during the year.

Notes to the current cost accounts (continued)

2 Analysis of turnover and operating income of the appointed business

For the year ended 31 March

	Water supply £m	Sewerage service £m	2008 Appointed business £m	Water supply £m	Sewerage service £m	2007 Appointed business £m
Turnover						
Unmeasured	343.7	401.0	744.7	325.6	369.1	694.7
Measured	212.0	321.1	533.1	183.5	289.3	472.8
Trade effluent	-	23.5	23.5	-	23.0	23.0
Large user and special agreement	51.1	43.6	94.7	49.8	47.7	97.5
Revenue grants	-	(0.1)	(0.1)	-	0.6	0.6
Non-potable large user and special agreement	7.7	-	7.7	7.5	-	7.5
Rechargeable works	0.1	-	0.1	0.1	-	0.1
Bulk supplies/inter company payments	0.4	-	0.4	0.4	-	0.4
Other appointed business (third party)	8.8	-	8.8	8.8	1.0	9.8
Third party services - subtotal	9.3	-	9.3	9.3	1.0	10.3
Other sources	2.5	2.8	5.3	2.2	1.4	3.6
Total turnover	626.3	791.9	1,418.2	577.9	732.1	1,310.0
Operating income						
Current cost profit on disposal of fixed assets	3.7	0.4	4.1	3.0	0.4	3.4
Total operating income	3.7	0.4	4.1	3.0	0.4	3.4
Working capital adjustment	0.9	1.2	2.1	2.9	3.8	6.7

Notes to the current cost accounts (continued)

3 Current cost operating costs for the year ended 31 March 2008

Service analysis	Water supply			Sewerage service			Total appointed business £m	
	Resources and treatment £m	Distribution £m	Water supply subtotal £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m		Sewerage service subtotal £m
Direct costs								
Employment costs	9.4	10.0	19.4	4.7	9.4	7.8	21.9	41.3
Power	8.4	7.8	16.2	3.0	13.3	5.3	21.6	37.8
Hired and contracted services	2.4	14.7	17.1	10.3	4.9	7.8	23.0	40.1
Materials and consumables	9.3	0.4	9.7	0.4	5.3	4.6	10.3	20.0
Service charges	14.5	-	14.5	2.0	4.0	-	6.0	20.5
Bulk supply imports	1.2	-	1.2	-	-	-	-	1.2
Other direct costs	1.2	0.9	2.1	0.4	0.2	0.1	0.7	2.8
Total direct costs	46.4	33.8	80.2	20.8	37.1	25.6	83.5	163.7
General and support expenditure	20.4	21.5	41.9	7.8	24.4	16.9	49.1	91.0
Total functional expenditure	66.8	55.3	122.1	28.6	61.5	42.5	132.6	254.7
Business activities								
Customer services			36.8				38.2	75.0
Scientific services			8.0				2.6	10.6
Other business activities			3.3				3.3	6.6
Total business activities			48.1				44.1	92.2
Local authority rates			36.9				22.7	59.6
Doubtful debts			23.7				30.0	53.7
Exceptional items			2.4				2.1	4.5
Total operating expenditure less third party services			233.2				231.5	464.7
Third party services - operating expenditure			11.7				-	11.7
Total operating expenditure			244.9				231.5	476.4
Capital maintenance								
Infrastructure renewals charge	12.4	46.6	59.0	58.3	-	0.1	58.4	117.4
Current cost depreciation								
- service activities	69.1	26.2	95.3	20.7	115.1	27.0	162.8	258.1
- business activities			27.6				25.4	53.0
Amortisation of grants			(4.6)				(3.1)	(7.7)
Capital maintenance excluding third party services			177.3				243.5	420.8
Third party services								
- current cost depreciation			2.2				-	2.2
Total capital maintenance			179.5				243.5	423.0
Total operating costs			424.4				475.0	899.4
CCA (MEA) values								
Service activities	4,714.9	10,138.0	14,852.9	27,281.0	2,877.5	616.8	30,775.3	45,628.2
Business activities			103.6				105.7	209.3
Total			14,956.5				30,881.0	45,837.5
Services for the third parties			43.7				-	43.7
Total			15,000.2				30,881.0	45,881.2

The depreciation charge of £5.1 million on IT systems owned by United Utilities Water PLC, but recharged to other United Utilities companies, has been reclassified as operating expenditure in accordance with RAG 4.03.

Notes to the current cost accounts (continued)

3 Current cost operating costs (continued) for the year ended 31 March 2007

Service analysis	Water supply				Sewerage service			Total appointed business £m
	Resources and treatment £m	Distribution £m	Water supply subtotal £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewerage service subtotal £m	
Direct costs								
Employment costs	10.3	8.8	19.1	7.2	9.3	7.5	24.0	43.1
Power	8.9	9.3	18.2	4.8	16.6	7.2	28.6	46.8
Hired and contracted services	2.9	16.6	19.5	7.8	3.4	8.7	19.9	39.4
Materials and consumables	9.0	0.3	9.3	-	4.4	4.3	8.7	18.0
Service charges	13.8	-	13.8	2.0	3.9	-	5.9	19.7
Bulk supply imports	1.2	-	1.2	-	-	-	-	1.2
Other direct costs	0.9	1.2	2.1	0.3	0.2	0.1	0.6	2.7
Total direct costs	47.0	36.2	83.2	22.1	37.8	27.8	87.7	170.9
General and support expenditure	18.1	21.2	39.3	6.8	15.8	17.3	39.9	79.2
Functional expenditure	65.1	57.4	122.5	28.9	53.6	45.1	127.6	250.1
Operating expenditure								
Customer services			35.1				36.3	71.4
Scientific services			7.6				4.3	11.9
Other business activities			2.9				3.0	5.9
Total business activities			45.6				43.5	89.2
Local authority rates			24.0				30.6	54.6
Doubtful debts			17.1				21.7	38.8
Exceptional items			10.7				11.3	22.0
Total opex less third party services			219.9				234.8	454.7
Third party services operating expenditure			9.6				-	9.6
Total operating expenditure			229.5				234.8	464.3
Capital maintenance								
Infrastructure renewals charge	11.8	43.6	55.4	57.5	-	0.1	57.6	113.0
Current cost depreciation								
- service activities	65.9	25.5	91.4	19.6	107.9	26.3	153.8	245.2
- business activities			24.7				20.3	45.0
Amortisation of grants			(3.9)				(2.8)	(6.7)
Capital maintenance excluding third party services			167.6				228.9	396.5
Third party services								
- current cost depreciation			2.0				-	2.0
Total capital maintenance			169.6				228.9	398.5
Total operating costs			399.1				463.7	862.8
CCA (MEA) values								
Service activities	4,479.9	9,688.5	14,168.4	26,193.5	2,671.1	569.9	29,434.5	43,602.9
Business activities			102.0				95.3	197.3
Total			14,270.4				29,529.8	43,800.2
Services for the third parties			38.2				-	38.2
Total			14,308.6				29,529.8	43,838.4

The depreciation charge of £3.0 million on IT systems owned by United Utilities Water PLC, but recharged to other United Utilities companies, has been reclassified as operating expenditure in accordance with RAG 4.03.

Notes to the current cost accounts (continued)

4 Other income

	2008 £m	2007 £m
Net rents receivable	-	1.0

5 Current cost analysis of fixed assets by asset type as at 31 March 2008

Total services	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2007	9,395.5	144.5	37,815.8	450.7	47,806.5
RPI adjustment	352.2	5.1	1,424.8	15.3	1,797.4
Disposals	(50.5)	(7.2)	-	(39.1)	(96.8)
Additions	440.8	12.2	192.3	75.3	720.6
At 31 March 2008	10,138.0	154.6	39,432.9	502.2	50,227.7
Depreciation					
At 1 April 2007	3,654.8	59.9	-	253.4	3,968.1
RPI adjustment	136.1	2.0	-	8.3	146.4
Disposals	(50.3)	(7.0)	-	(29.1)	(86.4)
Charge for the year	250.7	7.4	-	60.3	318.4
At 31 March 2008	3,991.3	62.3	-	292.9	4,346.5
Net book value					
At 31 March 2008	6,146.7	92.3	39,432.9	209.3	45,881.2
At 31 March 2007	5,740.7	84.6	37,815.8	197.3	43,838.4
Water services					
	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2007	3,399.9	88.4	11,818.2	244.1	15,550.6
RPI adjustment	127.4	3.1	445.4	8.4	584.3
Disposals	(17.8)	(5.3)	-	(21.5)	(44.6)
Additions	156.1	6.4	87.9	36.1	286.5
At 31 March 2008	3,665.6	92.6	12,351.5	267.1	16,376.8
Depreciation					
At 1 April 2007	1,063.9	36.0	-	142.1	1,242.0
RPI adjustment	39.5	1.2	-	4.8	45.5
Disposals	(17.6)	(5.2)	-	(15.6)	(38.4)
Charge for the year	91.0	4.3	-	32.2	127.5
At 31 March 2008	1,176.8	36.3	-	163.5	1,376.6
Net book value					
At 31 March 2008	2,488.8	56.3	12,351.5	103.6	15,000.2
At 31 March 2007	2,336.0	52.4	11,818.2	102.0	14,308.6

Notes to the current cost accounts (continued)

5 Current cost analysis of fixed assets by asset type as at 31 March 2008 (continued)

Sewerage services	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2007	5,995.6	56.1	25,997.6	206.6	32,255.9
RPI adjustment	224.8	2.0	979.4	6.9	1,213.1
Disposals	(32.7)	(1.9)	-	(17.6)	(52.2)
Additions	284.7	5.8	104.4	39.2	434.1
At 31 March 2008	6,472.4	62.0	27,081.4	235.1	33,850.9
Depreciation					
At 1 April 2007	2,590.9	23.9	-	111.3	2,726.1
RPI adjustment	96.6	0.8	-	3.5	100.9
Disposals	(32.7)	(1.8)	-	(13.5)	(48.0)
Charge for the year	159.7	3.1	-	28.1	190.9
At 31 March 2008	2,814.5	26.0	-	129.4	2,969.9
Net book value					
At 31 March 2008	3,657.9	36.0	27,081.4	105.7	30,881.0
At 31 March 2007	3,404.7	32.2	25,997.6	95.3	29,529.8

6 Regulatory capital value (RCV)

	£m
Closing RCV at 31 March 2007	6,915.3
RCV inflation adjustment	260.5
Opening RCV at 1 April 2007	7,175.8
Capital expenditure (excluding infrastructure renewals expenditure)	590.9
Infrastructure renewals expenditure	121.1
Infrastructure renewals charge	(112.8)
Grants and contributions	(16.0)
Current cost depreciation	(333.2)
Outperformance of regulatory assumptions (5 years in arrears)	(42.7)
Closing RCV at 31 March 2008	7,383.1
Average RCV (2007/08 year average prices)	7,159.1

The figures in this table are consistent with those published by Ofwat in their letter RD09/07 (inflated to 2007/8 prices) and therefore do not agree with other actual values reflected in the company's regulatory financial statements. The differences from actual values will not affect price limits in the 2005–10 price review period. Capital efficiencies will be taken into account in the calculations of price limits for the 2010–15 price review period. All costs have been indexed to March 2008 (RPI - 212.1) prices, except for the average RCV, which is shown at year average prices (RPI - 208.6), in accordance with Ofwat's regulatory accounting guidelines.

In the previous price control period (2000–05), around £200 million of funding was provided to deliver a number of obligations, primarily relating to Unsatisfactory Intermittent Discharges (UIDs) of wastewater for that period, which have been carried over into 2005–10. UUW, in its negotiations with the Environment Agency and Ofwat, is seeking to finalise requirements relating to those UID outputs. The business expects the bulk of this capital expenditure to be incurred over the next 2-3 years.

Notes to the current cost accounts (continued)

6 Regulatory capital value (continued)

At the last price review, it was also recognised that there was potential for additional investment relating to projects that were not part of the company's 2005–10 regulatory contract, but which may be confirmed as additional obligations during this period by the regulators.

These potential projects, which primarily relate to UIDs from wastewater continue to be the subject of investigations and studies which are driving discussions with the regulators.

A planning inquiry was held in October 2006 which considered three appeals for UIDs discharging to inland waters to help establish principles going forward. The inspector's findings were published in January 2007. Based on the outcome of the inquiry, the company made an initial submission to Ofwat in October 2007 which was endorsed by Defra on 23 May 2008, to address a first set of UIDs. The funding implications of this submission have yet to be determined by Ofwat. A further planning inquiry was held in December 2007 which considered appeals for seven UIDs discharging to coastal waters. The inspector's findings were published in February 2008. As a result of the two planning inquiries, a further two submissions will be made to Ofwat in August 2008 and March 2009. Altogether these three submissions should allow the related investment programme, estimated to be up to £700 million, to be funded through price limits and deliver additional growth in the RCV.

7 Working capital

	2008 £m	2007 £m
Stocks	3.4	3.9
Trade debtors (see below)	149.0	122.8
Measured income accrual	50.1	53.3
Prepayments and other debtors	35.7	22.1
Trade creditors	(47.7)	(20.3)
Deferred income – customer advance receipts	(85.3)	(81.3)
Short-term capital creditors	(175.7)	(113.1)
Accruals and other creditors	(77.6)	(79.5)
Total working capital	(148.1)	(92.1)

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

	2008 £m	2007 £m
Measured household	20.4	15.0
Unmeasured household	63.5	55.3
Measured non-household	30.5	25.4
Unmeasured non-household	11.3	10.9
Other	23.3	16.2
Trade debtors	149.0	122.8

8 Movement on current cost reserve

	2008 £m	2007 £m
At 1 April	37,919.5	36,110.5
RPI adjustments		
Fixed assets	1,651.1	2,007.3
Working capital	(2.1)	(6.7)
Financing	(48.0)	(180.9)
Grants and third party contributions	(11.9)	(12.7)
Other adjustment	-	2.0
At 31 March	39,508.6	37,919.5

The other adjustment relates to a prior year reconciling item between the Regulatory Accounts and the June Return. This adjustment has been made to bring the 2007 Regulatory Accounts and the 2007 June Return into alignment.

Notes to the current cost accounts (continued)

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 2008:

	£m	Interest rate	Repayment date
United Utilities PLC: US \$ 400.0 million bonds	208.7	6.88%	August 2028
North West Water LLC: £364.5 million loan	205.5	6.18% to 7.25%	July 2034
United Utilities PLC: Loan facility of £300.0 million	223.1	5.81% to 6.30%	On demand

The company operates a daily balancing sweep banking arrangement with its parent United Utilities PLC. This has resulted in a £39.1 million inter-company creditor balance together with £1.0 million net interest payable for the year.

The following loans to associated companies existed at 31 March 2008:

	£m	Interest rate	Repayment date
United Utilities PLC	40.0	5.93% to 7.00%	On demand
United Utilities Investment Holdings (Water) Limited	497.4	6.45%	May 2008

Dividends paid to associated undertakings

During the year, ordinary dividends payable to United Utilities North West PLC totalled £299.3 million. This comprised a final dividend for the year ended 31 March 2007 of £196.3 million and an interim dividend of £103.0 million. A seven per cent preference share dividend of £9.1 million has also been included within net interest payable.

Dividend policy

The board reviewed the capital structure and dividend policy of the company in November 2007 when it approved in principle a one-off return of capital of £550.0 million as a special dividend. As a result of this special distribution, there will be a 30 per cent reduction in the 2008/09 dividend payment when compared to the 2007/08 dividend. The board expects the special dividend and revised dividend policy to increase the company's gearing level of net debt to regulatory capital value to the upper end of the Ofwat range (55 to 65 per cent for the 2005-10 price control period) and to enable it to maintain a sustainable capital structure consistent with the board's target credit rating of A3.

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.

Notes to the current cost accounts (continued)

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

Supply of services

Services supplied to the company by associated companies

Nature of transaction	Company	Terms of supply	2008 Total value of service £m
Group management charge	United Utilities PLC	Recharge of costs (see note below)	12.7
Accommodation	United Utilities Facilities Management Limited	Competitive Letting	9.8

Note: The group management charge of £12.7 million (2007: £10.0 million) from United Utilities PLC represents 38.7 per cent (2007: 43.5 per cent) of the total management charge to group companies. The group management charge represents the recharging of costs incurred centrally on behalf of group companies. This includes the chief executive's office, chairman's office, strategy, finance, company secretary, policy, corporate communications and human resources. The costs are allocated to group companies on the basis of time spent by each support area (as identified by the relevant managers/employees of these areas).

Services supplied by the company to associated companies

Nature of transaction	Company	Terms of supply	Total value of service £m
Shared services	United Utilities Electricity Services Limited	Recharge of costs	8.8
Shared services	United Utilities Electricity Ltd	Recharge of costs	0.4

Note: Shared services mainly include procurement and transport services.

Turnover of associated companies based on the Regulatory Accounting Guideline 5.04 commentary for the year ended 31 March 2008

	2008 £m
United Utilities Facilities Management Limited	27.3
United Utilities Electricity Services Limited	228.9
United Utilities Electricity Limited	223.7
United Utilities PLC	-

Notes to the current cost accounts (continued)

10 Interest rate risk profile

At 31 March	2008 Fixed rate £m	2008 Floating rate £m	2008 Index-linked £m	2008 Total £m
Maturity profile				
Due within one year	478.4	274.8	-	753.2
Due between one and two years	148.8	11.9	-	160.7
Due between two and five years	0.8	233.6	-	234.4
Due between five and twenty years	846.8	10.7	209.0	1,066.5
Due after more than twenty years	481.8	205.5	1,324.4	2,011.7
Borrowings (excluding preference shares)	1,956.6	736.5	1,533.4	4,226.5
Preference share capital				130.0
Total borrowings				4,356.5
Overdrafts				88.4
Less: Short term deposits (intercompany loan)				(538.1)
Net debt				3,906.8

At 31 March	2007 Fixed rate £m	2007 Floating rate £m	2007 Index-linked £m	2007 Total £m
Maturity profile				
Due within one year	879.0	81.8	-	960.8
Due between one and two years	408.6	243.2	-	651.8
Due between two and five years	146.5	233.7	-	380.2
Due between five and twenty years	830.2	17.4	200.7	1,048.3
Due after more than twenty years	432.7	-	1,092.4	1,525.1
Borrowings (excluding preference shares)	2,697.0	576.1	1,293.1	4,566.2
Preference share capital				130.0
Total borrowings				4,696.2
Overdrafts				25.9
Less: Short term deposits (intercompany loan)				(1,347.6)
Net debt				3,374.5

The disclosure in respect of 2007 has been represented using a maturity profile approach, as the directors consider this to better reflect the requirements of RAG 3.06.

Notes to the current cost accounts (continued)

11 Differences between historic cost regulatory accounts and statutory accounts

	Statutory (UK GAAP) £m	Regulatory Total Business £m	Difference £m	Explanation of difference
Profit and loss account				
Operating profit	651.1	641.0	(10.1)	During 2007/08, £2.1 million (2007: £3.7 million) of expenditure relating to aqueduct security of supply work and £4.1 million (2006/07: £nil) of expenditure 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 aqueduct security of supply work 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 upon the Company's interpretation of RAG 2.03. These two items have resulted in an additional £10.9 million (2007: £7.8 million) infrastructure renewals charge in the regulatory accounts. An adjustment of £2.6 million (2007: £2.4 million) has also been made to the deferred taxation charge as a result of this treatment. In addition, due to change in accounting for revenue and debt associated with 'Live the occupier' (LTO), £0.9 million (2007: £nil) has been recorded as turnover net of bad debt charge in the regulatory accounts, as requested by Ofwat. Neither the LTO turnover nor the bad debt charge has been recorded in the statutory accounts. An adjustment of £0.3 million (2007: £nil) has also been made to the deferred taxation charge as a result of this treatment. The difference in tax represents the current and deferred tax impact of the regulatory adjustments detailed above.
Profit before tax	457.5	447.4	(10.1)	
Tax	(93.1)	(90.8)	2.3	
Balance Sheet				
Tangible fixed assets (net book value)	7,178.9	7,171.7	(7.2)	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 £21.7 million (2007: £35.3 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 accrual of £28.0 million (2007: £36.9 million) is therefore shown within creditors falling due within one year in the regulatory accounts. The difference between the infrastructure renewals accrual in the statutory accounts and that in the regulatory accounts arises from the differences in interpretation of infrastructure renewals accounting policies as explained in the profit and loss section above. The statutory accounts fixed assets include the cumulative value of the aqueduct security of supply work and DG5 flooding programme capitalisation of £28.9 million (2007: £22.8 million).
Short-term deposits	-	538.1	538.1	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.

Notes to the current cost accounts (continued)

11 Differences between historic cost regulatory accounts and statutory accounts (continued)

	Statutory (UK GAAP) £m	Regulatory Total Business £m	Difference £m	Explanation of difference
Creditors: amounts falling due within one year	(1,488.7)	(1,380.7)	108.0	<p>Per RAG 3.06 the £130.0 million (2007: £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 creditors falling due within one year within the statutory accounts.</p> <p>The infrastructure renewals accrual of £28.0 million (2007: £36.9 million) is disclosed in creditors in line with RAG 3.06 but the equivalent figure of £21.7 million (2007: £35.3 million) is shown within tangible fixed assets in the statutory accounts.</p> <p>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 within creditors due within one year (£6.1 million) and creditors falling due after one year (£86.1 million).</p>
Creditors: amounts falling due after one year	(3,584.9)	(3,498.8)	86.1	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 pensions liability)	(416.7)	(499.0)	(82.3)	Provisions are £92.2 million higher in the regulatory accounts due to the classification of deferred grants as detailed above. This increase is partially offset by a lower deferred tax provision (£9.9 million) in the regulatory accounts due to the impact of the difference in the infrastructure renewals policy and capitalisation of the aqueduct security of supply work and the DG5 flooding programme between the statutory and regulatory accounts.
Preference share capital	-	(130.0)	(130.0)	Per RAG 3.06 the £130.0 million (2007: £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 creditors falling due within one year within the statutory accounts.

Notes to the current cost accounts (continued)

12 Directors' pay and standards of performance

During the year ended 31 March 2008 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 three categories:

- United Utilities Water PLC (UUV PLC) directors (For the purpose of this disclosure, C Cornish, who sits on the boards of United Utilities PLC and UUV PLC is classified in his role as a director of United Utilities PLC);
- United Utilities PLC directors (which includes C Cornish and T Weller); and
- Non-executive directors.

At the start of each financial year or the date of appointment, whichever is later, a bonus scheme is implemented for all employees including directors. Through the United Utilities bonus scheme, the UUV PLC directors received remuneration linked to water service standards in order to ensure that the directors are incentivised to deliver improvements in those standards. As part of the scheme, their performance was assessed against the following water service measures:

Measure	Target	Actual
1 Achieve the target percentage score in the customer satisfaction index (experience rating)	77	73
2 Achieve the target points score in Ofwat's overall performance assessment (OPA)	404	343
3 Achieve the quality outputs relating to treatment works, UIDs and flooding register	1,322	1,342
4 Achievement of NW90 ferrous water mains outputs	682	650
5 Number of bacteriological compliance failures at treatment works (including E.coli)	6	8
6 Achieve reduction in leakage levels (Ml/day)	465	462
7 Achievement of Relative Efficiency on Operating expenditure for water supply	Band A	Band B
8 Achievement of Relative Efficiency on Operating expenditure for sewerage service	Band B	Band C

Details of the bonus arrangements for the UUV PLC directors, in respect of the measures identified above, for the year ended 31 March 2008 are as follows:

Director	Service related bonus
J Barnes	£nil
M Beesley	£nil
C Brook	£nil
G Dixon	£4,719
C Elphick	£3,983
B Hurd	£2,474
I McAulay	£nil
G Sims	£nil
M Wright	£nil

The bonus for achieving each of these standards above was based on a balanced scorecard for both company and departmental objectives. The remainder of the directors' salary was based on a competitive benchmark. In arriving at an outcome for the bonuses, standards of performance are assessed by the United Utilities PLC Remuneration Committee to ascertain whether targets were achieved. In addition, the directors also reviewed relevant reports from Ofwat in assessing the achievement of standards of performance.

For the forthcoming year, the United Utilities PLC bonus scheme has been assessed and continues to reflect the importance of achieving service standards. Performance will again be assessed against key measures including leakage, bacteriological compliance and OPA scores, which are routinely used by Ofwat to determine company performance.

The non-executive directors were paid no remuneration linked to water service standards. The United Utilities PLC directors also partake in the Group bonus scheme as documented in the United Utilities PLC accounts and receive no bonus in respect of service standards.

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