

# **United Utilities PLC**

## **Report and Financial Statements**

31 March 2009

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Registered no. 2366616

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## Chairman's statement

This has been another year of good progress for United Utilities. We continue to benefit from a robust financing position and have headroom to cover our projected financing needs through to mid-2011.

We continue to concentrate on the four key areas that I highlighted last year: improving operational performance; successfully delivering our 2005-10 regulatory contract; the 2009 water price review; and delivering our non-regulated strategy. We believe that our strategy and objectives are aligned with our overall goal of delivering shareholder value and benefits for all stakeholders.

### **Improving operational performance**

We continue to work hard on improving operational performance and have made good progress during the year. Although we are measured on many things, we have highlighted five key performance indicators against which our operational performance can be assessed. These are: relative efficiency; security of water supply (leakage); serious pollution incidents; sewer flooding; and overall customer satisfaction in response to enquiries.

We are pleased to report that overall customer satisfaction is at its highest level for many years and that we met our leakage target for the third consecutive year, despite this year's harsher winter which made the target more challenging. We have also halved the number of serious pollution incidents over the last few years. Although we have made good progress, we know that there is more to do and are strongly focused on making further improvements.

### **Successfully delivering our 2005-10 regulatory contract**

We have now completed four years out of our current five-year regulated water and wastewater contract in the North West of England. We are investing over £3 billion in our infrastructure between 2005 and 2010, which allows us to maintain and improve the service we provide to our customers and to meet tough environmental standards. We have a clear plan for the final year of this price review period and are confident of meeting our regulatory targets.

### **The 2009 water price review**

2009 is an important year for the group as the economic regulator, Ofwat, will set price limits for the regulated business for the five years from 1 April 2010 to 31 March 2015. We submitted our draft business plan to Ofwat in August 2008 and our final plan in April 2009, which was welcomed by the Consumer Council for Water. The plan is the first step in our long-term vision for our business as it adapts to the changing climate and demographics in the North West.

The proposed capital investment programme in our plan aims to safeguard existing standards of service, address new, higher quality standards and make provision for the challenge of climate change. We do recognise that we need to maintain the affordability of customer bills, especially in what is a tough economic environment, and this was a key feature of the business plan we submitted to Ofwat. Whilst we expect to continue to fund significant levels of capital investment beyond 2010, we believe that our service, which on average costs domestic households around £1 per day for high quality drinking water and environmentally responsible wastewater collection and treatment, represents excellent value for money. We are also increasing the funding of our Charitable Trust by 67 per cent to £5 million per year to help more customers who are struggling to pay their water bills.

With the proposals in our business plan, independent research indicates that we will support some 15,000 jobs in the North West region and approximately 20,000 jobs across the UK.

Ofwat is expected to set out its initial thoughts on price limits and its final determination is scheduled for November 2009.

## **Chairman's statement (continued)**

### **Delivering our non-regulated strategy**

We have continued to look for opportunities to apply our core skills on an asset-light basis. These opportunities can generate additional shareholder value with little impact on the group's risk profile.

Early in the year we extended the contract with Southern Water to 2015, which consolidates our position as the leading utility infrastructure outsourcing company in the UK. We are also pleased to have been selected as the preferred bidder for a 27-year municipal solid waste treatment contract in Derbyshire. In Australia, we have been awarded a 20-year desalination operations and maintenance contract in Adelaide.

### **Outlook**

We expect to deliver a sound underlying financial performance in the final year of this price review period, although the group is experiencing ongoing revenue and cost pressures. United Utilities continues to benefit from a robust financing position and has headroom to cover its projected financing needs through to mid-2011. In line with the group's policy the board expects to grow dividends for 2009/10 by five per cent.

We will continue to implement our strategy of focusing on our core skills, with the aim of delivering benefits for all of our stakeholders. I am encouraged by the progress we have made and confident that we can build on this in the year ahead.

PN Green  
Chairman  
July 2009

## Business review

### Key performance indicators

United Utilities monitors a large number of financial and non-financial key performance indicators (KPIs) to assess its performance. The non-financial KPIs include targets set by regulatory bodies. We believe that those featured below provide an overall picture of our business. Additional non-financial KPIs are provided in our online corporate responsibility report at [unitedutilities.com/crreport2009](http://unitedutilities.com/crreport2009)

	2008/09	2007/08
<b>Financial</b>		
Revenue from continuing operations	£2,434.7m	£2,362.9m
Operating profit from continuing operations	£735.2m	£663.2m
Underlying <sup>(1)</sup> operating profit from continuing operations	£741.8m	£677.2m
Profit before taxation from continuing operations	£568.7m	£478.3m
Underlying <sup>(1)</sup> profit before taxation from continuing operations	£570.7m	£475.6m
Total dividends per ordinary share	36.71p	46.67p
<b>Environment</b>		
Pollution incidents <sup>(2)</sup>	11	9
Water quality – mean zonal compliance <sup>(3)</sup>	99.92%	99.94%
Renewable energy generated <sup>(4)</sup>	100GWh	93GWh
<b>Employees</b>		
Employee engagement – employee opinion survey	76%	63%
Health and safety – incident rate per 100,000 employees	778	1,101
<b>Customers</b>		
Water – relative efficiency banding <sup>(5)</sup>	Band B	Band B
Wastewater – relative efficiency banding <sup>(5)</sup>	Band C	Band C
Leakage – rolling annual average leakage <sup>(6)</sup>	462 Ml/d	462 Ml/d
Overall customer satisfaction – water (in response to enquiries)	76%	76%

**Notes:**

- (1) Underlying operating profit and underlying profit before tax are defined in the underlying profit measure table on page 13.
- (2) Number of category 1 & 2 incidents during the year as defined by the Environment Agency. Figures stated are for the years ended 31 December 2008 and 2007.
- (3) 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 ended 31 December 2008 and 31 December 2007.
- (4) In 2008/09 100 GWh of renewable energy was generated, the equivalent of 53,788 tonnes of carbon dioxide.
- (5) Relative efficiency is the operating expenditure relative efficiency band as assessed by Ofwat for the years ended 31 March 2008 and 31 March 2007. 2008/09 assessment is due to be published by Ofwat later in the year.
- (6) Annual rolling average leakage – figures given are in megalitres per day for the years ended 31 December 2008 and 31 December 2007. The Ofwat Regulatory rolling average leakage target was 465 megalitres per day.

## **Business review (continued)**

### **Business description**

On 28 July 2008, a new statutory holding company structure became effective by way of a share exchange between United Utilities PLC (the group's previous listed holding company) and United Utilities Group PLC (the new holding company) and United Utilities Group PLC became the listed holding company of the group.

United Utilities PLC is the intermediate holding company of the UK's largest listed water business. The group owns and manages the regulated water and wastewater network in the North West of England and also applies its core skills to operate water, wastewater, electricity and gas networks in competitive markets, principally in the UK.

United Utilities reports through three business segments:

- regulated activities;
- non-regulated activities; and
- other activities (includes the group's central costs and property business).

### **Regulated activities**

#### **Key facts**

- 95 water treatment works
- 184 reservoirs
- Over 1,400 kilometres of aqueducts
- Over 40,000 kilometres of water pipes
- Over 57,000 hectares of catchment land
- 582 wastewater treatment works
- Over 43,000 kilometres of sewers
- Serving a population of seven million people

United Utilities Water PLC ('UW') holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England.

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

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

UW is regulated in terms of both price and performance by an independent body, Ofwat, which sets price limits every five years for the water sector in England and Wales. Current price limits were fixed in 2004. Ofwat is due to publish its final determination of price limits for the period 1 April 2010 to 31 March 2015 in November 2009. Once Ofwat has published its final determination, water companies have two months to decide whether to accept the determination or instead to have price limits referred to and set by the Competition Commission.

## **Business review (continued)**

### **Business description (continued)**

Consistent with the group's approach to longer-term asset planning, the needs of the North West region to 2035 were considered in U UW's strategic direction statement, 'where we are heading', which sets out its plans for the next price review period (2010-15) in a longer-term context. The six key elements identified in the strategic direction statement are:

- responsible stewardship of water and wastewater networks;
- listening to customers and other stakeholders;
- ensuring water resources are more sustainable and resilient;
- an integrated approach to drainage to reduce the threat of flooding;
- reducing significantly the carbon impact of activities; and
- bills to rise, on average, no faster than incomes.

In the 2005-2010 period, U UW is investing more than £3 billion to improve the water and wastewater infrastructure and the environment across the North West. Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive, the Drinking Water Directive and the Environmental Liability Directive).

Since privatisation in 1990:

- water quality in the North West region has improved from 99.6 per cent to 99.9 per cent;
- compliance with bathing water standards across the North West has risen from just over 30 per cent to more than 90 per cent;
- leakage from the network has halved, supported by ongoing investment in replacing ageing water pipes; and
- United Utilities has invested more than £4,000 for every household in the North West, some £750 above the national average.

### **Non-regulated activities**

#### **Major contracts - description**

- British Gas Trading – meter installation services
- Dŵr Cymru Welsh Water – water and wastewater services
- Electricity North West – operational and maintenance services
- Northern Gas Networks – operational and maintenance services and supporting its capital investment programme
- Scottish Water – supporting its capital investment programme
- Southern Water – supporting its capital investment programme

As well as owning and managing the water and wastewater network in the North West of England, United Utilities also applies those core skills through outsourced utility contracts, now serving more than 20 million people, principally in the UK.

## Business review (continued)

### Business description (continued)

The group has major contracts with Dŵr Cymru Welsh Water, Electricity North West, Northern Gas Networks, Scottish Water and Southern Water. In addition, United Utilities has a meter installation contract with British Gas Trading, as well as three Scottish private finance initiative operations, relating to water and wastewater infrastructure.

Existing overseas water and wastewater operations are managed through a number of subsidiaries and joint ventures in parts of Australia, Bulgaria, Estonia, the Philippines and Poland.

United Utilities continues to seek asset-light opportunities by leveraging its core skills in areas that generate additional shareholder value with little impact on the risk profile of the group.

### Performance summary

#### Group results (continuing operations)

	Year ended 31 March 2009 £m	Year ended 31 March 2008 £m	Change
Operating profit	735.2	663.2	+11%
Underlying operating profit <sup>(1)</sup>	741.8	677.2	+10%
Profit before taxation	568.7	478.3	+19%
Underlying profit before taxation <sup>(1)</sup>	570.7	475.6	+20%

- Strong results in a challenging environment: underlying operating profit <sup>(1)</sup> up 10 per cent to £741.8 million
- Financing position remains robust: headroom through to mid-2011
- £740 million invested in regulated water and wastewater infrastructure during the year
- Regulatory leakage target achieved for third consecutive year
- Customer satisfaction continues to improve
- Final business plan for 2010-15 submitted to Ofwat in April 2009

**Note:**

(1) Underlying operating profit and underlying profit before taxation are defined in the underlying profit measure table on page 13.

### Financial review

United Utilities has delivered a strong set of financial results for the year ended 31 March 2009. Revenue from continuing operations rose by three per cent to £2,435 million. Underlying profit before tax <sup>(1)</sup> increased by 20 per cent to £570.7 million and underlying operating profit was up by 10 per cent to £742 million.

Regulated activities have delivered strong growth this year with operating profit up 11 per cent. This result primarily reflects the price increase allowed by the regulator and tight cost control. This price increase helps fund the high levels of essential investment in our assets, which allows the business to meet strict environmental standards and deliver an improved service for customers.

Capital expenditure in the regulated water and wastewater business amounted to £740 million during the year, including infrastructure renewals expenditure. This high level of spend is consistent with the planned investment profile and reflects the peak phase of the current 2005-10 capital expenditure programme. Overall, the group remains in line with regulatory assumptions on both expenditure and outputs.

## **Business review (continued)**

### **Financial review (continued)**

United Utilities' business improvement initiatives are delivering benefits and the group remains broadly on track to meet regulatory efficiency targets across this price review period, although cost pressures in areas such as power and bad debts are expected to continue through 2009/10. In particular, the early progress of the workforce management project, which has been successfully implemented on time and below budget, is encouraging. This integrated system is a key initiative in increasing productivity by using real time data across the workforce to enable more effective work scheduling. The system should improve both efficiency and customer service. Cost savings in the order of £7 million per annum are expected by 2010.

Non-regulated activities have delivered good underlying operating profit growth of nine per cent. This principally reflects the planned increase in activity on the Scottish Water contract, an increase in contribution from the group's international operations and a benefit realised from foreign exchange rate movements. Overall, the performance across our non-regulated contract portfolio is pleasing. The group's order book remains strong at over £6 billion in revenue and United Utilities continues to be the leading utility infrastructure outsourcing business in the UK.

During the year the group enhanced its liquidity, raising over £1 billion of debt finance, via a £400 million 12-year term loan facility with the European Investment Bank, a £375 million 6.125 per cent, seven-year bond and a £275 million 5.75 per cent, 13-year bond. In addition, this was supplemented through the arrangement of additional bank facilities and renewal of core relationship banking facilities which matured during the period. This provides good flexibility in terms of when and how to raise further debt finance.

### **Investment income and finance expense**

Finance expense of £273 million was £59 million lower than the prior year. This expense included a £24 million net fair value loss on debt and derivative instruments, compared with a £43 million net fair value loss in the previous year. This volatility in financing expense reflects the fact that, in order to provide a hedge of the interest cost implicit in the regulatory period, the group fixes interest rates for the duration of each five-year review period for the majority of its debt using interest rate swaps. IAS 39 limits the use of hedge accounting for these commercial hedges, thereby increasing the potential volatility of the income statement. 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 in fair values has no cashflow impact. Interest expense on swaps and debt under the fair value option was £8 million, £33 million lower than the comparative period, primarily due to the derivative contracts associated with a €1 billion 6.625 per cent bond, which matured in November 2007. During 2008/09, indexation of the principle of index-linked debt amounted to a charge of £28 million compared with a charge of £55 million in the previous year due to the benefit of lower RPI impacting on the second half of the year.

Investment income was £106 million, compared with £147 million in the previous year, principally reflecting lower net pension interest and a reduction in cash due to the repayment of debt, including the repayment of a \$500 million bond on 1 April 2008. The underlying cost of net borrowings for continuing operations of £157 million was £50 million lower than the prior year.

### **Profit before taxation**

Profit before taxation increased by 19 per cent to £569 million. Underlying profit before taxation was £571 million, 20 per cent ahead of the results for the year ended 31 March 2008. This underlying measure adjusts for the impact of one-off items, fair value movements in respect of debt and derivative instruments, interest on swaps and debt under fair value option and the short-term interest benefit associated with the cash proceeds from the sale of United Utilities Electricity (UUE).

## **Business review (continued)**

### **Financial review (continued)**

#### **Taxation**

The current tax charge relating to continuing operations was £150 million and the current tax effective rate was 26 per cent compared with 19 per cent in the previous year. The increase in the current tax rate principally relates to fair value movement in derivatives, the cessation of deductions for the 2005 pension prepayment and a net reduction in capital allowances claimed, partly offset by the reduction in the corporation tax rate from 30 per cent to 28 per cent. These timing differences are matched by equal and opposite movements in deferred tax.

The group has recognised a one-off deferred tax charge of £206 million relating to the abolition of industrial buildings allowances. This one-off item has resulted in a significant increase in the effective tax rate for the year ended 31 March 2009. However, the cash impact will be spread over a period of approximately 20 years.

The total deferred tax charge relating to continuing operations is £210 million compared with a deferred tax credit in the prior year of £27 million, which reflected the restatement of the opening deferred tax liability following the reduction in the corporation tax rate from 30 per cent to 28 per cent with effect from April 2008.

An overall tax charge of £360 million relating to continuing operations has been recognised for the year ended 31 March 2009. Excluding the impact of the abolition of industrial buildings allowances and the change in corporation tax rate in the prior year, the total tax charge relating to continuing operations would be £154 million or 27 per cent compared with a £144 million charge or 30 per cent in the prior year. It is expected that the group's effective tax rate for 2009/10 will be broadly in line with the mainstream UK corporation tax rate of 28 per cent.

#### **Dividends per share**

The board has proposed a final dividend of 17.15 pence per share in respect of the year ended 31 March 2009. Including the first interim dividend of 11.34 pence per share and the second interim dividend of 8.22 pence per share, which have already been paid, the total dividend for 2008/09 is 36.71 pence per share.

The group's revised dividend policy is intended to target a sustainable and growing level of dividends. The new target real growth rate of RPI+2 per cent will be applied from 2009/10 to the 2008/09 dividend per share. In line with this policy, the board expects to grow dividends for 2009/10 by five per cent. This incorporates an inflationary increase of three per cent, which is based on the RPI element included within the allowed regulated price increase for UUW for the 2009/10 financial year (i.e. the movement in RPI between November 2007 and November 2008).

#### **Cashflow**

Cash used in the group's continuing operations for the year ended 31 March 2009 was £571 million, compared with £877 million generated in the prior year. High levels of capital expenditure have continued, principally in the regulated water and wastewater investment programmes. The group's capital expenditure on property, plant and equipment for the year was £675 million, excluding infrastructure renewals expenditure which is treated as an operating cost under IFRS.

Net debt, including derivatives, at 31 March 2009 was £4,941 million, an increase of £2,038 million compared with 31 March 2008. This movement principally reflects expenditure on the regulatory capital investment programme, payment of dividends and payments of interest and tax, partly offset by operational cashflows.

## **Business review (continued)**

### **Financial review (continued)**

#### **Debt financing and interest rate management**

As expected, gearing (measured as group net borrowings divided by U UW's regulatory capital value) increased to 67 per cent at 31 March 2009, compared with 39 per cent at 31 March 2008. Adjusting for the group's non-recourse joint venture debt of £230 million, gearing is 64 per cent. The board continues to target an A3 credit rating for United Utilities Water PLC. At the year end, United Utilities Water PLC had stable long-term credit ratings of A3/A- and United Utilities PLC had stable long-term credit ratings of Baa1/BBB+ from Moody's Investor Services and Standard and Poor's Ratings Services respectively.

During the year, United Utilities repaid a \$500 million 6.45 per cent bond and a €600 million 4.875 per cent bond from existing cash resources. Cash and short-term deposits on the balance sheet at 31 March 2009 amounted to £299 million. United Utilities has a long-standing relationship with the European Investment Bank and during the year enhanced its liquidity further via a new £400 million term loan facility for U UW to support the remainder of the company's current capital investment programme. In addition, U UW issued a £375 million 6.125 per cent, seven-year bond, a £275 million 5.75 per cent, 13-year bond and £35 million of floating rate Japanese Yen notes, maturing in 2017. In total, the group raised over £1 billion of term funding during the financial year.

The group has access to the international debt capital markets through its €7 billion medium-term note programme which provides for the periodic issuance by United Utilities PLC and United Utilities Water PLC of debt instruments on terms and conditions determined at the time the instruments are issued. The programme does not represent a funding commitment, with funding dependent on the successful issue of the debt securities.

Long-term borrowings are structured or hedged to match 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 group's preferred form of funding as this provides a natural hedge to earnings and assets. At the year-end, approximately 40 per cent of the group's net debt was in index-linked form, representing around 27 per cent of U UW's regulatory capital value, 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 group's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile which is in excess of 25 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 group's policy is to seek to match the debt service costs to regulatory cashflow which is impacted by the general interest rate environment at the time of each price control determination and is then fixed for the five-year period of that price control. To hedge the exposure to each price control determination, the group enters into interest rate swaps, around the time of each price control determination, to fix interest costs for a substantial proportion of the group's debt for the duration of that price control period. The group does not undertake any speculative trading activity.

The group enters into joint ventures with consortium partners. The financial and legal structure of joint ventures is designed to limit the group's exposure to the extent of the equity investment and loans provided by the group, with no further recourse should the joint venture default. All joint venture arrangements have been incorporated into the group's results on a proportionate consolidation basis.

#### **Liquidity**

Short-term liquidity requirements are met from the group's normal operating cashflow and its short-term bank deposits. Further liquidity is provided by committed but undrawn credit facilities. This liquidity supports the group's €2 billion euro-commercial paper programme.

## **Business review (continued)**

### **Financial review (continued)**

#### **Liquidity (continued)**

In line with the board's treasury policy, United Utilities aims to maintain a healthy headroom position. Available headroom at 31 March 2009 was £935 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover United Utilities projected financing needs through to mid-2011.

United Utilities believes that it operates a prudent approach to managing banking counterparty risk. The group does not have any cash (or cash equivalents) invested in money market funds. Its cash is held in the form of short-term (generally no longer than three months) money market deposits with prime commercial banks.

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

## Business review (continued)

### Underlying profit (continuing activities)

In considering the results for the year, the directors have adjusted the group's statutory measures for fair value movements on debt and derivative instruments, interest on swaps and debt under fair value option and those significant items identified as non-recurring. Operating profit and profit before taxation from continuing operations are reconciled to underlying operating profit from continuing operations and underlying profit before taxation from continuing operations as follows:

#### Year ended 31 March 2009

	Regulated activities £m	Non- regulated activities £m	Other activities £m	Total £m
Operating profit/(loss) per published results	678.4	69.1	(12.3)	735.2
One-off items <sup>(1)</sup>	1.0	(1.0)	6.6	6.6
Underlying operating profit/(loss)	679.4	68.1	(5.7)	741.8

#### Year ended 31 March 2008

	Regulated activities £m	Non- regulated activities £m	Other activities £m	Total £m
Operating profit per published results	611.6	50.6	1.0	663.2
One-off items <sup>(1)</sup>	2.6	11.6	(0.2)	14.0
Underlying operating profit	614.2	62.2	0.8	677.2

	Year ended 31 March 2009 £m	Year ended 31 March 2008 £m
Profit before taxation per published results	568.7	478.3
Operating profit adjustments (see above)	6.6	14.0
Net fair value losses on debt and derivative instruments	24.3	42.7
Interest on swaps and debt under fair value option	(8.3)	(41.7)
Interest associated with cash proceeds from UUE sale <sup>(2)</sup>	(20.6)	(17.7)
Underlying profit before taxation	570.7	475.6

## Business review (continued)

### Underlying profit (continuing activities - continued)

	2009 £m	2008 £m
Finance expense	272.5	331.6
Net fair value losses	(24.3)	(42.7)
Interest on swaps and debt under fair value option	8.3	41.7
Underlying interest payable	256.5	330.6
Investment income	(106.0)	(146.7)
Adjustment for net pension interest income	6.8	23.5
Underlying cost of net borrowings	157.3	207.4
Add back adjustment for net pension interest income	(6.8)	(23.5)
Interest associated with cash proceeds from UUE sale <sup>(2)</sup>	20.6	17.7
Underlying net interest payable	171.1	201.6

**Notes:**

- (1) Principally relates to the capital restructuring associated with the £1.5 billion return to shareholders by United Utilities Group PLC (contained within the other activities segment) and restructuring within the business.
- (2) The interest associated with the cash proceeds from the sale of UUE has been deducted to provide a more representative view of underlying performance. As the cash proceeds from the sale of UUE were held by the group until the return to shareholders of approximately £1.5 billion by United Utilities Group PLC in August 2008, this resulted in a short-term net debt and interest reduction.

### Regulated activities

Revenue from regulated activities increased by six per cent to £1,500 million, principally as a result of an allowed price increase of 7.8 per cent (including inflation), partially offset by lower water demand. As expected and indicated previously, this level of growth is consistent with the position at the half year. The regulated price increase supports significant investment in UUE's infrastructure which provides vital clean water and wastewater services to customers.

Operating profit for the year increased by 11 per cent on an underlying basis, primarily reflecting the allowed price increase and tight cost control, partly offset by higher depreciation and power costs. The higher depreciation charge reflects the high levels of capital spend, in line with the planned profile of the investment programme. In line with UUE's policy, the business has entered into forward contracts for the bulk of its power requirements for 2009/10. This means that unit power costs in the forthcoming financial year are expected to be in the order of 10 per cent higher than in 2008/09. Bad debt expense is similar to the prior year, although this represents a marginally lower proportion of regulated revenue at 3.4 per cent compared with 3.6 per cent in 2007/08. However, cash collection continues to be challenging.

Capital investment in the year, including £118 million of infrastructure renewals expenditure, was £740 million. This high level of spend reflects the capital investment profile, as UUE completes the peak phase of its 2005-10 regulatory programme. After adjusting for the revised sewage sludge strategy, as agreed with Ofwat, cumulative capital expenditure on water and wastewater assets remains broadly in line with agreed regulatory assumptions. Overall, the business remains on course to meet its capital expenditure regulatory efficiency targets and deliver its outputs across the 2005-10 period.

## Business review (continued)

### Regulated activities (continued)

#### Operational performance

Operational performance is a key area of focus and U UW is targeting an upper quartile position among UK water companies on key operational measures in the medium term. The regulated business continues to upgrade its infrastructure, replacing 227 kilometres of water mains during the year. U UW continues to supply a high quality of drinking water, with a mean zonal compliance water quality performance for the year of 99.92 per cent.

U UW is making good progress against its key performance indicators:

- Relative efficiency – U UW has closed the operational efficiency gap to the most efficient water companies over the last three years. This is reflected in Ofwat’s most recent (2007/08) assessment of United Utilities 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 three-year period.
- Security of water supply – U UW met its economic level of leakage rolling target for the third consecutive year in 2008/09, despite unfavourable winter weather conditions which made this target more challenging. This follows a period where the company had not met this target for five years. In addition, no water restrictions were required during the year.
- Pollution – The business has now met or outperformed its medium-term target of a 50 per cent reduction in major pollution incidents in each of the last three years. One water and 10 wastewater Category 1&2 incidents were recorded in 2008 compared with the base position of two water and 21 wastewater incidents in 2005. In addition, U UW has more than halved the number of failing wastewater treatment works from 18 works in 2007 to seven works in 2008, and performance so far this year has been encouraging.
- Sewer flooding – U UW continues to remove properties from the sewer flooding register. Ofwat has published a review of how registers of properties at risk of sewer flooding are compiled and reported in the water sector in England and Wales. U UW is currently in discussion with Ofwat regarding its methodology and processes in this area. This is expected to result in a restatement of the number of properties on U UW’s sewer flooding registers, with a resulting increase in these numbers in terms of both the start point in 2005/06 and the current position. However, it is envisaged that the restated numbers will still demonstrate progress over this period. U UW aims to build on the progress achieved over the last three years and will provide a further update when its sewer flooding registers have been reassessed. Following completion of this review, U UW expects to restate its historical overall performance assessment (OPA) scores for the three years 2004/05 through 2006/07 in relation to ‘flooding other causes’ and is in discussion with Ofwat regarding the extent of these restatements.
- Overall customer satisfaction – significant improvements have been delivered. Overall customer satisfaction, in response to enquiries, has improved from less than 50 per cent in 2005 to consistently over 70 per cent. These satisfaction levels are based upon a comprehensive independent survey conducted on behalf of U UW each month. Further progress has been achieved and customer satisfaction is now at its highest levels for many years, with a satisfaction rating of 76 per cent for 2008/09. The rating for the final month of the year was 80 per cent. The business remains focused on achieving further improvements.

Although U UW has delivered real progress, the business recognises that there is more to do. Sewer flooding incidents, influenced by adverse weather, together with environmental underperformance at Fleetwood wastewater treatment works are expected to continue to impact the 2008/09 OPA score. A funded capital investment programme has already been initiated at the Fleetwood works and an improvement in performance is expected in the medium-term.

## **Business review (continued)**

### **Regulated activities (continued)**

#### **Efficiency initiatives**

UUW is broadly on track to meet its regulatory efficiency targets across the 2005-10 period, although the business is facing ongoing cost pressures in areas such as power and bad debts.

The company's principal efficiency initiatives include an integrated performance management project, which increases remote operational site management and optimises chemical and power usage, and its asset improvement programme which is improving the efficiency of operational pumps. These schemes are key elements of United Utilities' plan to mitigate its carbon emissions, alongside its combined heat and power assets which recycle energy generated from wastewater treatment processes. UUW has been awarded the Carbon Trust standard; and the business has developed the technology to convert biogas, a by product of the sludge treatment process, into bio-methane for vehicle fuel and potentially to export into the natural gas distribution network.

Other key initiatives include supply chain management, which has been centralised and is delivering procurement economies, and a workforce management project. There is a strong drive to improve customer service and the business is focusing on reducing the number of customer queries, improving staff productivity and implementing improved cash collection procedures.

The workforce management system is a key initiative in increasing the efficiency of frontline staff, by using real time data across the workforce to enable more effective work scheduling. This project has been successfully implemented on time and below budget; early progress is encouraging. The system should provide the dual benefits of reducing the cost to serve and improving customer satisfaction. Cost savings of approximately £7 million per annum are expected by 2010.

#### **2009 Water price review**

UUW submitted its draft water and wastewater business plan, covering the 2010-15 period, to Ofwat in August 2008 and submitted its final plan on 7 April 2009, entitled 'Planning for the future'. These submissions form part of the 2009 water price review process and build on the company's strategic direction statement published in December 2007. The business has worked hard to strike the right balance between improvements in the network and the impact on the bills paid by its customers. The final plan was welcomed by the Consumer Council for Water and supported by UUW's independent engineering Reporter, Halcrow, which described the capital investment assessment as well considered, comprehensive and robust.

The total capital investment programme contained within the final plan, including infrastructure renewals expenditure, is approximately £3.7 billion (2007/08 prices), comprising £1.3 billion for the water service and £2.4 billion for the wastewater service. This compares with a programme of just over £3 billion in the 2005-10 period. Investment to meet regulatory quality standards, enhance the service to customers and maintain the supply/demand balance is forecast at around £1.8 billion. The remainder relates to essential maintenance of the water and wastewater infrastructure. Having raised over £1 billion of debt finance in the last year, the business would expect to borrow £1.6 billion across the five-year period 2010-15 to finance this plan.

The planned 2010-15 capital investment programme takes account of the geography and industrial legacy of the North West of England. It aims to maintain and improve current service standards and address new tighter quality standards as well as making provision for the challenge of climate change. The total proposed capital expenditure programme in the final plan is £3,704 million, compared with £4,035 million in the draft plan. The principal reductions are the deferral and removal of outputs (£433 million), the impact of recession on growth (£119 million) and greater future efficiency (£130 million partly offset by the inclusion of further projects relating to sewer overflows/unsatisfactory intermittent discharges (£351 million).

## **Business review (continued)**

### **Regulated activities (continued)**

UUW expects to improve its efficiency further across the 2010-15 period. The business is aiming for a 1.5 per cent annual improvement in its underlying operating efficiency, although operating expenditure is likely to increase overall due to cost pressures in areas such as property rates and pensions. UUW is also targeting an average improvement in efficiency of between four per cent and eight per cent across the five-year period in respect of its capital investment programme.

UUW estimates that to finance this plan an average real, fully post-tax return of 4.85 per cent is required, which it believes would support an A3 credit rating. This compares with a cost of capital of 5.1 per cent assumed by Ofwat at the last price review in 2004, reflecting the reduction in the cost of debt finance available to the water sector during the early part of the 2005-10 period. However, this return represents an increase of approximately 0.2 per cent compared with the required return in the draft business plan, following UUW's reassessment of its financing costs in light of recent financial market conditions. This reassessment is supported by NERA Economic Consulting's (NERA) recently updated independent research ('Cost of Capital for PR09 – A Final Report for Water UK', January 2009) which has concluded that a higher cost of capital in the range of 4.6 per cent to 5.1 per cent (fully post-tax, real) would be appropriate for the UK water industry. NERA intends to reassess this cost of capital range later in the year.

United Utilities believes that Ofwat should ensure that water companies can at least maintain an A3 credit 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, make provision for climate change and deliver further statutory environmental obligations and customer priorities. The board believes this to be an appropriate investment grade rating to allow UUW to raise finance to fund its substantial capital investment programmes, particularly in light of conditions in the debt markets over the last 12 months.

UUW believes that its services, which on average costs households around £1 per day for the supply of high quality drinking water and for environmentally responsible wastewater collection and treatment, represents excellent value for money. Within this plan, average household bills would increase by seven pence per day in real terms by 2015. This equates to an average real price increase of 1.8 per cent across UUW's customer base during the 2010-15 period. The business believes this plan is consistent with its aim that bills, on average, should rise no faster than medium-term household income growth.

The next stage of the price review process is publication of the draft determination by Ofwat in July 2009, with the final determination due in November 2009.

### **Non-regulated activities and other activities**

Non-regulated revenue was marginally lower at £919 million, reflecting the impact of the slowdown in the UK property market on the group's utility connections business. However, underlying operating profit increased by nine per cent compared with the prior year. This principally reflects the planned increase in activity on the Scottish Water contract and an increase in contribution from the company's international operations, including the benefit of foreign exchange rate movements which amounted to £2.9 million.

### **Business update**

United Utilities is the leading utility infrastructure outsourcing business in the UK, applying the core utility skills from its regulated activities. United Utilities holds major outsourcing contracts working on behalf of Dŵr Cymru Welsh Water, Southern Water, Scottish Water, Electricity North West, Northern Gas Networks and British Gas Trading (meter installation).

## **Business review (continued)**

### **Non-regulated activities and other activities (continued)**

#### **Business update (continued)**

United Utilities also has a meter ownership contract with British Gas Trading which provides a revenue stream to the group through rental income once the meters have been installed. In addition, United Utilities has a 15 per cent stake in Northern Gas Networks, three Scottish PFI operations and operations in Bulgaria, Estonia, Poland, the Philippines and Australia which provide a steady income stream.

In December 2008, United Utilities was selected as preferred bidder for a municipal solid waste treatment contract in Derbyshire, via a joint venture with Interserve. The contract is due to commence in April 2010 with an expected duration of 27 years. Subsequently, United Utilities also secured a 20-year desalination operations and maintenance contract in Adelaide, through its joint venture with Acciona Agua. It is expected that this contract will commence in mid-2011.

#### **Other activities**

As expected, other activities delivered a small underlying operating loss of £6 million during the year, as central costs were partly offset by a small contribution from United Utilities Property Solutions (UUPS). UUPS is the property sales and management business of the group and, as indicated previously, has been affected by the slowdown in the UK property market.

One-off costs of £7 million were incurred in 2008/09. These costs principally relate to the capital restructuring associated with the £1.5 billion return to shareholders by United Utilities Group PLC.

### **Principal risks and uncertainties**

The group faces a variety of risks and uncertainties, both foreseeable and unforeseeable which, if they materialise, could adversely affect its reputation, profitability or financial position. The principal ones are summarised below.

The group maintains an internal control framework that seeks to identify, assess and manage exposures to internal and external risks. This requires management to assess the nature and magnitude of risks consistently and, in the absence of appropriate controls, to implement risk mitigation strategies in a prioritised manner. The framework's effectiveness is reviewed by the audit committee.

#### **Unfavourable price determination**

##### ***Risk***

The regulated business operates in an industry which is substantially influenced by the service levels, regulatory targets and price determinations set by its primary regulator, Ofwat, as well as Ofwat's assessment of its delivery against these.

An adverse outcome to the price determination process (which limits the income the regulated business can receive from its customers) could occur for a number of reasons. These include an inadequate allowed cost of capital, turnover forecasts proving not to be sufficiently accurate, or unforeseen or unforeseeable costs which arise after the determination that cannot be recovered from customers. After a price determination, there is a right of appeal to the Competition Commission, but otherwise the scope to review the outcome within the relevant five-year period is limited. Review mechanisms can also be invoked by Ofwat to reduce the prices for customers. Furthermore, implicit within the price determination are assumptions by Ofwat concerning the group's future operating expenditure and the achievement of operating cost savings. If these efficiencies are not achieved this may be reflected in less favourable outcomes in Ofwat's future price determinations.

## **Business review (continued)**

### **Principal risks and uncertainties (continued)**

#### **Unfavourable price determination (continued)**

##### *Mitigation*

In April this year, the group submitted its final business plan to Ofwat for the 2009 price review for the regulated business, which will set prices for the five-year period from April 2010. This plan endeavours to ensure that the assumptions and projections underlying Ofwat's price determination are accurate and achievable. The group has committed substantive and qualified resource to ensuring the quality of its submissions throughout the price determination process to give it the best prospect of receiving a satisfactory determination. The submission process includes an assessment of the risks associated with each component of the business to assist Ofwat's understanding of these. Ofwat's draft determination will be published in July 2009 and its final determination of allowable prices is expected to be published in November 2009.

#### **Capital investment programmes**

##### *Risk*

The regulated business requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities. Historically, the group has financed this capital expenditure from operating cashflow and from external debt and equity financing. There can be no assurance that operating cashflows will not decline or that external debt financing and other sources of capital will be available, at similar cost to that assumed by Ofwat, in order to meet these capital expenditure requirements. Delivery of capital investment programmes could also be affected by a number of factors including adverse legacy effects of earlier capital investments or amounts budgeted in prior capital investment programmes proving insufficient to meet the actual amount required. This may affect the group's ability to meet regulatory and other environmental performance standards, which may result in fines imposed by Ofwat of an amount of up to 10 per cent of regulated business turnover or other sanctions.

##### *Mitigation*

In order to minimise the likelihood of funding shortfalls, capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for out-performance. Development of the programme for 2010-15 is progressing in line with expectations, as is delivery of the current capital investment programme.

#### **Current capital market conditions**

##### *Risk*

The global banking crisis continues to impact the debt and equity capital markets. It has resulted in the cost of capital increasing significantly and has made the issuance of new equity and debt capital more expensive and more difficult to secure. A compounding challenge arises from the relationship between the Regulatory Capital Value (RCV) of the regulated business and the Retail Price Index (RPI). The RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this. This may lead to pressure on the gearing ratios and credit ratings of the regulated business and the group as a whole and increase the cost or limit the availability of credit in an already difficult market. In the extreme, the group may be required to increase its equity base by either reducing its dividend payments or raising new equity capital. The global economic crisis has also created difficult trading and financing conditions for customers, contractors and suppliers of materials and/or services to the group.

## **Business review (continued)**

### **Principal risks and uncertainties (continued)**

#### **Current capital market conditions (continued)**

##### *Mitigation*

The group closely monitors its liquidity headroom within the parameters approved by the board, the impact of trends in inflation or deflation on its capital position as well as the potential impact of wider changes in the credit markets. Where possible, the group has sought to issue debt linked to RPI to minimise the extent of its exposure to deflationary (or low inflationary) conditions. The group also monitors the financial position of its key contractors and suppliers and seeks to use its procurement processes to ensure that alternative suppliers can be sourced quickly and, where possible, on similar terms.

#### **Pension scheme obligations**

##### *Risk*

The group participates in a number of pension arrangements, predominantly in the UK. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of group finances, with the funds being well diversified and professionally managed. Reflecting the global economic environment, the group's current schemes had a combined IAS 19 deficit of £213 million as at 31 March 2009, compared with a deficit of £101 million as at 31 March 2008 and a deficit of £253 million as at 30 September 2008.

##### *Mitigation*

Increases to pension deficits may result in an increased liability for the group, the size of which depends upon the extent to which additional deficits are recoverable through the regulatory price determination process. The regulated business is in ongoing dialogue with Ofwat concerning the allowances for increased pension scheme deficits within the price determination process for the 2010-2015 period. The group monitors the scheme's investment strategy implementation and assesses changes in the group's exposure to liability.

#### **Failure to comply with applicable law or regulations**

##### *Risk*

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

##### *Mitigation*

The group endeavours to comply with all legal requirements in accordance with its business principles and robust processes are in place to seek to mitigate against non-compliance. The regulated business is certified to both ISO 9001 and 14001 standards and the group continually monitors legislative and regulatory developments and, where appropriate, participates in consultations to seek to influence their outcome, either directly or through industry trade associations for wider issues. The group seeks appropriate funding for any additional compliance costs in the regulated business as part of the price determination process.

## **Business review (continued)**

### **Principal risks and uncertainties (continued)**

#### **Increased competition in the water and wastewater industry**

##### ***Risk***

The Cave review of competition and innovation in water markets was published in April 2009. If its recommendations are implemented, this would eventually expand the competitive market allowing retail competition to all non-household customers. Ofwat has also taken steps to introduce competition into the water supply market through inset appointments and the water licensing supply regime. Prior to 2007 (with one exception), inset appointees had all been granted to existing regulated companies. Since 2007, Ofwat has granted more inset appointments, two of which are within UUU's region. Further inset appointments may be made in the future, resulting in increased competition.

##### ***Mitigation***

The group has been fully engaged in the Ofwat consultations on the Cave review, although a relatively small proportion of the group's profits derives directly from non-household retail activities. If competition is expanded, there would be opportunities for the group to participate in a wider market in England and Wales. As far as inset appointments are concerned, these generally relate to new developments or large industrial customers. Furthermore, the regulated business has not received any applications from holders of water supply licences to supply any premises within its region.

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

##### ***Risk***

The group controls and operates utility networks and maintains the associated assets with the objective of providing a continuous service. In exceptional circumstances, electricity, gas or water shortages or the failure of an asset, an element of a network or supporting plant and equipment could result in the interruption of service provision or catastrophic damage resulting in significant loss of life and/or environmental damage and/or economic and social disruption. The group could be fined for breaches of statutory obligations or held liable to third parties, or be required to provide an alternative water supply of equivalent quality, which could increase costs. The group is also dependent on the ability to access, utilise and communicate remotely via electronic software applications mounted upon corporate information technology hardware and communicating through internal and external networks. The ownership, maintenance and recovery of such applications, hardware and networks are not wholly under its control.

##### ***Mitigation***

The group operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, together with risk management and business continuity procedures, recognising that possible events have varying impacts and likelihoods. While the group seeks to ensure that it has appropriate processes in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of customers, regulators, government and the wider stakeholder community. The group also maintains insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost effectively. The regulated business's licence also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat in the event of a major incident.

## **Business review (continued)**

### **Principal risks and uncertainties (continued)**

#### **Risks in the group's non-regulated business**

##### ***Risk***

Outside the regulated business, the group provides services relating to the operation and management of assets for other utility clients in the UK and overseas. These services include the maintenance and operation of electricity, gas and water networks, the design and construction of new assets, the design and construction of new connections to the relevant network and the provision of ancillary services. The delivery of contracts, both existing and future, will be achieved by exploiting the group's core infrastructure management skills and may also require capital expenditure. The overstretching of such skills could lead to a loss of customers or the inability to meet contractual commitments, or to the incurrance of penalties.

##### ***Mitigation***

The costs and risks associated with these new projects are subject to internal reviews before approval is given to commit to them. The group aims to comply with its contractual commitments or operating performance targets and any requirements to maintain service continuity or achieve specified operating efficiencies in relation to those clients. Within the non-regulated business, the focus is on deploying the group's core skills on an asset-light basis, whilst continually monitoring contract performance, together with programme and project management.

#### **Material litigation**

##### ***Risk***

NOSS Consortium (NOSS), of which North West Water International Limited, a wholly owned subsidiary of United Utilities Group PLC, is a member and the sole remaining active participant, is party to arbitration proceedings in Thailand in relation to a design and construction contract dated 1 November 1993 between NOSS and the Bangkok Metropolitan Administration (BMA) to build a wastewater treatment plant and network in central Bangkok. Following disagreements with the engineer (Dorsch Consult) and disputes with the BMA, NOSS terminated the contract with the BMA and served a notice of arbitration. NOSS has total claims against the BMA of approximately six billion baht. The BMA has counter claimed for approximately three billion baht; however, based upon the facts and matters currently known, the counter claim appears to lack substance. Although there have been some delays in the arbitral process, the arbitration now appears set to proceed.

In February 2009 the group was served with notice of a multiparty 'class action' in Argentina into which United Utilities International Limited (UUIL) was enjoined in 2007. The class action is related to the issuance and payment default of a US\$230 million bond by Inversora Eléctrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks, which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The class action is being pursued against various parties, including the original direct and indirect shareholders of IEBA, the banks which advised IEBA and the rating agencies of the bonds. The bonds, which were issued in 1997, were defaulted in March 2002 and IEBA entered an insolvency process in 2003. The claim is for a non-quantified amount of unspecified damages, and purports to be pursued on behalf of unidentified consumer bondholders in IEBA who allegedly lost money. UUIL has filed a defence to the action and will vigorously resist the proceedings, given the robust defences that UUIL has been advised that it has on procedural and substantive grounds.

## **Business review (continued)**

### **Principal risks and uncertainties (continued)**

#### **Material litigation (continued)**

##### *Mitigation*

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

#### **Cautionary statement regarding forward looking statements**

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

## Directors' report

The directors present their report and the audited financial statements of United Utilities PLC (the company) and its subsidiaries (together referred to as 'the group') for the year ended 31 March 2009.

### Principal activities and business review

The company is the intermediate holding company of a group which owns and operates water and wastewater assets and also manages infrastructure for other businesses, predominantly within the United Kingdom.

The business review (pages 5 to 23), which includes the financial review (pages 8 to 12), and the Chairman's statement (pages 3 to 4), provide a balanced analysis of the development and performance of the group's business during the financial year, and the position of the group's business at the year end, and forms part of this directors' report. A summary of key performance indicators can be found on page 5. A summary of the principal risks and uncertainties can be found on pages 18 to 23. An indication of likely future developments of the group is included in the Chairman's statement. The company's principal subsidiary undertakings, and the associated companies and joint ventures in which the group participates, are listed in note 13 to the consolidated financial statements.

### New statutory holding company

On 28 July 2008, a new statutory holding company structure became effective by way of a share exchange between the shareholders of United Utilities PLC (the previous listed holding company) and United Utilities Group PLC (the new listed holding company) and United Utilities Group PLC became the listed holding company of the group.

### Dividends

The directors have recommended a final dividend of 17.15 pence per share for the year ended 31 March 2009, which together with the first interim dividend of 11.34 pence and the second interim dividend of 8.22 pence, gives a total dividend for the year of 36.71 pence for each ordinary share (the interim and final dividends paid in respect of the 2008 financial year were 15.20 pence and 31.47 pence respectively).

### Directors

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

CED Bell	(resigned 28 July 2008)
NN Broadhurst	(resigned 25 July 2008)
C Cornish	
RH Evans	(resigned 25 July 2008)
PN Green	
P Heiden	(resigned 28 July 2008)
DH Jones	(resigned 28 July 2008)
JDG McAdam	(resigned 28 July 2008)
JA Pinder	(resigned 28 July 2008)
NR Salmon	(resigned 28 July 2008)
TP Weller	

### Purchase of own shares

At the annual general meeting of United Utilities PLC held on 25 July 2008, shareholders authorised that company was to purchase, in the market, up to 88,170,881 of its own ordinary shares of £1 each. No shares were purchased pursuant to that authority during the year. Such authority will expire at the conclusion of the company's annual general meeting in 2010 or earlier if on 30 September 2010.

## Directors' report (continued)

### **Directors' indemnities and insurance**

The company has in place contractual entitlements for directors of the company and of its subsidiaries to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. The company also maintains an appropriate level of directors' and officers' liability insurance.

### **Political and charitable donations**

The group's policy is not to make any donations for political purposes. However, the Companies Act 2006 requires certain types of expenditure on political events to be pre-approved by shareholders. At the 2008 annual general meeting, an authority was taken to cover such expenditure. Pursuant to that authority, in the year, the group incurred expenditure of £27,702 (2008: £5,314) as part of the process of engaging in dialogue with government regionally and nationally. A similar resolution will be put to the shareholders of United Utilities Group PLC at the 2009 annual general meeting to authorise the company and its subsidiaries to make such expenditure. Charitable donations by the group in the year amounted to £4,262,520 (2008: £3,790,569).

### **Employees**

#### ***Benefits and lifestyle***

United Utilities recognises the importance of work-life balance and provides a range of benefits in support of that balance. Policies on maternity, paternity, adoption, personal and special leave go beyond requisite legal obligations as an employer. Pension provision is a particularly valued core benefit and more than 92 per cent of employees are members of pension schemes. A flexible benefits scheme is also open to all employees.

#### ***Dignity and equality***

United Utilities' business principles make it clear that in everything it does, the company seeks to act with integrity and fairness and observe legal requirements. Any employee with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or by using a contact number that can be called in confidence.

#### ***Disabilities***

United Utilities is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, it gives equal consideration to applicants with disabilities in the employment criteria and will modify equipment and working practices wherever it is safe and practical to do so. The group has retained the 'double tick' positive disabled people award.

#### ***Employee relations***

The group and its trade unions continue to strive towards developing an approach of working together under an employee relations framework. This looks not just at what needs to be done but how to enable the development of positive working relationships. Both parties share a commitment to this success and are committed to developing positive working relationships.

#### ***Engagement***

The continued engagement of employees is a key factor to the success of the group. Through independently verified annual employee surveys and 'pulse' surveys, progress with engagement and employee feedback upon management's response to it are measured. The factors assessed include: how employees think about the group; how they fit in; how they feel in terms of pride and attachment to the group; and are they motivated to go beyond the requirements of their day job.

A record number of employees had their say in the 2008/09 survey, with a response rate of 93 per cent. The group achieved an employee engagement score of 76 per cent, exceeding the target of 70 per cent, building towards a target of 85 per cent engagement by 2010.

## **Directors' report (continued)**

### ***Health and safety***

In 2008/09, the group enhanced its approach to health and safety, integrating a new management framework into its business operations, allowing a focus on measuring and reducing risks proactively and improving corporate governance. The reported accident incident rate per 100,000 employees (injuries causing more than one day's absence) decreased from 1,101 to 778. In recognising that this can be improved, a 10 per cent reduction has been targeted by 2010.

The reported accident incident rate per 100,000 employees (injuries causing more than one day's absence) decreased significantly from 1,101 to 778. In recognising that this can be improved, a 10 per cent reduction has been targeted by 2010.

There have also been two major successes through working in partnership with two key clients. In our contract with Northern Gas Networks, United Utilities achieved a 40 per cent reduction in lost time injuries. It also won the IGEM/SBGI 2008 gas industry safety award. The 4D consortium, of which United Utilities is a part, in its contract with Southern Water, worked for more than a year without a single accident; equivalent to more than 4.2 million man hours without incident.

### **Essential contractual relationships**

Certain suppliers to the group contribute key goods or services, the loss of which could cause disruption to the group's services. However, none are so vital that their loss would affect the viability of the group as a whole. Nor is the business of the group overly dependent on any one individual customer.

### **Policy on payment of creditors**

The group's policy is in line with the CBI Code of Prompt Payment (copies are available from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DW). 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 2009, the average credit period taken for trade purchases was 34 days for the group (2008: 29 days) and 9 days (2008: 18 days) for the company.

### **Approach to technology development**

The group is committed to using innovative, cost-effective and practical solutions for providing high quality services. It recognises the importance of ensuring that it properly focuses its investment in the development of technology, that it has the right skills to apply technology to achieve sustainable competitive advantage and that it continues to be alert to emerging technological opportunities.

### **Financial instruments**

The risk management objectives and policies of the company can be found in note 18 to the financial statements.

### **Fixed assets**

The group holds significant land assets; however, the vast majority of these are water catchment assets which are an integral and essential part of the operation of the group's regulated business. The nature of these assets, which are primarily moorland areas, and which could not be sold by the group, means that it is impractical to obtain meaningful market values for the land. Other land owned by the group does not have a market value materially different from historic cost.

### **Events occurring after the balance sheet date**

Details of events after the balance sheet date are included in note 30 to the consolidated financial statements.

## Directors' report (continued)

### Information given to the auditors

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

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

### Reappointment of auditors

On 1 December 2008 Deloitte & Touche LLP changed its name to Deloitte LLP. The board is proposing that shareholders re-appoint Deloitte LLP as auditors at the forthcoming annual general meeting and authorise the directors to fix the auditors' remuneration.

Approved by the board on 10 July 2009 and signed on its behalf by:

TS Keevil  
Company secretary

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

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to be properly prepared in accordance with IFRSs as adopted by the European Union and the Companies Act 1985.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

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.

## **Independent auditors' report**

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

We have audited the group and parent company financial statements (the "financial statements") of United Utilities PLC for the year ended 31 March 2009 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated and parent company balance sheets, the consolidated and parent company cashflow statements 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 annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union 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 (UK 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 business review and the chairman's statement that is cross-referred from the principal activities and business review 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 the annual report.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK 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 group's and 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.

## **Independent auditors' report (continued)**

to the members of United Utilities PLC

### **Opinion**

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2009 and of its profit for the year then ended;
- the parent company's financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 March 2009;
- 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 LLP**

Chartered Accountants and Registered Auditors  
Manchester, United Kingdom  
10 July 2009

## Consolidated income statement

for the year ended 31 March

	Note	2009 £m	2008 £m
<i>Continuing operations</i>			
<b>Revenue</b>	1,2	2,434.7	2,362.9
Other income	4	18.5	21.3
Employee benefits expense	3	(347.2)	(317.5)
Depreciation and amortisation expense	4	(263.5)	(248.2)
Infrastructure renewals expenditure		(117.8)	(120.1)
Other operating costs	4	(989.5)	(1,035.2)
<b>Total operating expenses</b>		(1,699.5)	(1,699.7)
<b>Operating profit</b>	2,4	735.2	663.2
Investment income	5	106.0	146.7
Finance expense	6	(272.5)	(331.6)
Investment income and finance expense		(166.5)	(184.9)
<b>Profit before taxation</b>		568.7	478.3
Current taxation charge		(149.9)	(88.6)
Deferred taxation charge		(3.7)	(55.1)
Deferred taxation charge – abolition of industrial buildings allowances		(206.4)	-
Deferred taxation credit – change in taxation rate		-	81.7
<b>Taxation</b>	7	(360.0)	(62.0)
<b>Profit for the year from continuing operations</b>		208.7	416.3
<i>Discontinued operations</i>			
(Loss)/profit for the year/period from discontinued operations	8	(1.2)	492.9
<b>Profit for the year</b>		207.5	909.2

## Statement of recognised income and expense

for the year ended 31 March

		<b>2009</b>	2008
		<b>£m</b>	£m
<b>Group</b>	Note		
Actuarial losses on defined benefit pension schemes	19,23	(124.3)	(126.4)
Revaluation of investments	13,23	(20.3)	34.9
Fair value losses on cashflow hedges	23	(1.6)	(1.5)
Foreign exchange adjustments	23	8.5	11.8
Tax on items taken directly to equity	20,23	35.2	35.8
<b>Net expense recognised directly in equity</b>		<u>(102.5)</u>	<u>(45.4)</u>
Profit for the year	23	207.5	909.2
<b>Total recognised income and expense for the year</b>		<u>105.0</u>	<u>863.8</u>

## Balance sheets

at 31 March

	Note	2009 £m	Group 2008 £m	2009 £m	Company 2008 £m
<b>ASSETS</b>					
<b>Non-current assets</b>					
Property, plant and equipment	10	7,977.2	7,591.8	0.4	0.5
Goodwill	11	2.6	2.3	-	-
Other intangible assets	12	106.1	85.3	-	-
Investments	13	136.8	155.5	11,481.3	5,352.3
Trade and other receivables	15	21.5	28.2	-	-
Deferred tax asset	20	-	-	7.9	4.8
Derivative financial instruments	18	412.6	44.3	172.8	-
		<u>8,656.8</u>	<u>7,907.4</u>	<u>11,662.4</u>	<u>5,357.6</u>
<b>Current assets</b>					
Inventories	14	73.0	63.3	-	-
Trade and other receivables	15	1,974.2	456.2	1,760.1	1,299.9
Cash and short-term deposits	16	298.6	1,810.5	100.8	663.8
Derivative financial instruments	18	226.4	99.0	1.8	0.9
		<u>2,572.2</u>	<u>2,429.0</u>	<u>1,862.7</u>	<u>1,964.6</u>
<b>Total assets</b>		<u>11,229.0</u>	<u>10,336.4</u>	<u>13,525.1</u>	<u>7,322.2</u>
<b>LIABILITIES</b>					
<b>Non-current liabilities</b>					
Trade and other payables	22	(139.8)	(125.5)	-	-
Borrowings	17	(5,200.1)	(3,788.9)	(759.2)	(521.3)
Retirement benefit obligations	19	(213.1)	(101.2)	(19.7)	(15.4)
Deferred tax liabilities	20	(1,338.9)	(1,164.0)	-	-
Provisions	21	(17.2)	(18.7)	-	(8.5)
Derivative financial instruments	18	(4.5)	(53.2)	-	(30.1)
		<u>(6,913.6)</u>	<u>(5,251.5)</u>	<u>(778.9)</u>	<u>(575.3)</u>
<b>Current liabilities</b>					
Trade and other payables	22	(673.7)	(771.9)	(6,276.6)	(615.6)
Borrowings	17	(524.9)	(878.4)	(890.1)	(856.0)
Current income tax liabilities		(78.3)	(66.9)	-	-
Provisions	21	(22.6)	(21.0)	(2.5)	(4.4)
Derivative financial instruments	18	(148.6)	(136.7)	(6.6)	(51.8)
		<u>(1,448.1)</u>	<u>(1,874.9)</u>	<u>(7,175.8)</u>	<u>(1,527.8)</u>
<b>Total liabilities</b>		<u>(8,361.7)</u>	<u>(7,126.4)</u>	<u>(7,954.7)</u>	<u>(2,103.1)</u>
<b>Total net assets</b>		<u>2,867.3</u>	<u>3,210.0</u>	<u>5,570.4</u>	<u>5,219.1</u>
<b>EQUITY</b>					
<b>Capital and reserves attributable to equity holders of the company</b>					
Share capital	23,24	881.8	881.6	881.8	881.6
Share premium account	23	1,430.0	1,429.3	1,430.0	1,429.3
Revaluation reserve	23	158.8	158.8	-	-
Treasury shares	23	-	(0.3)	-	(0.3)
Cumulative exchange reserve	23	16.1	7.6	-	(1.1)
Other reserves	23	36.6	58.1	-	-
Retained earnings	23	344.0	674.9	3,258.6	2,909.6
<b>Shareholders' equity</b>		<u>2,867.3</u>	<u>3,210.0</u>	<u>5,570.4</u>	<u>5,219.1</u>

Approved by the board of directors on 10 July 2009 and signed on its behalf by:

**C Cornish, Director**

## Cashflow statements

for the year ended 31 March

	Note	2009 £m	Group 2008 £m	2009 £m	Company 2008 £m
<b>Operating activities</b>					
Cash (used in)/generated from operations	28	(570.9)	876.9	205.4	1,293.2
Interest paid		(232.4)	(299.9)	(74.8)	(62.2)
Interest received and similar income		131.0	119.1	9.6	12.6
Tax paid		(32.8)	(98.6)	(30.3)	(133.7)
<b>Net cash (used in)/generated from operating activities (continuing operations)</b>		<b>(705.1)</b>	<b>597.5</b>	<b>109.9</b>	<b>1,109.9</b>
<b>Net cash generated from operating activities (discontinued operations)</b>	28	-	99.5	-	-
		<b>(705.1)</b>	<b>697.0</b>	<b>109.9</b>	<b>1,109.9</b>
<b>Investing activities</b>					
Disposal of investments		-	0.6	-	-
Disposal of associated company	8	-	75.8	-	75.8
Disposal of subsidiaries		-	1,152.7	-	-
Net cash outflow from group reorganisation		-	(15.0)	-	-
Investment in subsidiaries		-	-	(2.0)	-
Purchase of property, plant and equipment		(675.2)	(644.5)	-	-
Purchase of other intangible assets		(38.9)	(25.3)	-	-
Proceeds from sale of property, plant and equipment		3.8	15.0	-	-
<b>Net cash (used in)/generated from investing activities (continuing operations)</b>		<b>(710.3)</b>	<b>559.3</b>	<b>(2.0)</b>	<b>75.8</b>
<b>Net cash used in investing activities (discontinued operations)</b>		-	(161.0)	-	-
		<b>(710.3)</b>	<b>398.3</b>	<b>(2.0)</b>	<b>75.8</b>
<b>Financing activities</b>					
Proceeds from issue of ordinary shares		0.9	9.2	0.9	9.2
Cash used in structured financing		(163.9)	(170.1)	-	-
Proceeds from borrowings		3,847.6	1,068.9	1,724.5	805.3
Repayment of borrowings		(3,310.9)	(2,297.2)	(1,948.0)	(1,272.7)
Dividends paid to equity holders of the company	9	(449.9)	(400.4)	(449.9)	(400.4)
Dividends received from discontinued operations		-	100.0	-	-
<b>Net cash used in financing activities (continuing operations)</b>		<b>(76.2)</b>	<b>(1,689.6)</b>	<b>(672.5)</b>	<b>(858.6)</b>
<b>Net cash used in financing activities (discontinued operations)</b>		-	(190.1)	-	-
		<b>(76.2)</b>	<b>(1,879.7)</b>	<b>(672.5)</b>	<b>(858.6)</b>
Effects of exchange rate changes (continuing operations)		(1.8)	148.9	-	-
<b>Net (decrease)/increase in cash and cash equivalents (continuing operations)</b>		<b>(1,493.4)</b>	<b>(383.9)</b>	<b>(564.6)</b>	<b>327.1</b>
<b>Net decrease in cash and cash equivalents (discontinued operations)</b>		-	(251.6)	-	-
		<b>(1,493.4)</b>	<b>(635.5)</b>	<b>(564.6)</b>	<b>327.1</b>
Cash and cash equivalents at beginning of the year	16	1,705.2	2,340.7	663.8	336.7
Cash and cash equivalents at end of the year	16	211.8	1,705.2	99.2	663.8

## Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below.

### **Basis of preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU), including International Accounting Standards (IAS) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments.

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

IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction' has been adopted during the year with no material impact on the group's financial statements. The interpretation was endorsed by the EU on 16 December 2008.

### *Going concern*

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This approach, taking into account the relatively stable and regulated nature of the business, is based, amongst other matters, upon a review of the company's budget for the year ended 31 March 2010, the company's proposed five-year business plan and investment programme (in line with the plans submitted for the 2009 water price review), together with a review of the cash and committed borrowing facilities available to the company (discussed in further detail in the liquidity section on pages 11 and 12) and the debt financing and interest rate management section on page 11. This review shows that the group, at 31 March 2009, had headroom of £935 million based on cash and short-term deposits, medium-term committed bank facilities and net of short-term debt, which is sufficient to cover the company's projected financing needs through to mid-2011.

The board also took into account potential contingent liabilities and other risk factors as interpreted by the guidance given in 'Going Concern and Financial Reporting: Guidance for Directors of Listed Companies registered in the United Kingdom', published in November 1994, the guidance published in November 2008 'An update for Directors of Listed Companies: Going Concern and Liquidity Risk' and the May 2009 exposure draft updating going concern guidance for directors as published by the Financial Reporting Council.

### *Operating profit*

Operating profit is stated after charging operating expenses but before investment income and finance expense.

### **Basis of consolidation**

The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries), made up to 31 March each year, and incorporate the results of its share of jointly controlled entities using proportionate consolidation.

The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the date control is obtained or until the date that control ceases, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used under the relevant local GAAP into line with those used by the group.

## Accounting policies (continued)

### **Basis of consolidation (continued)**

#### *Subsidiaries*

Control is achieved where the company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights of an investee entity so as to obtain benefits from its activities.

In the parent company accounts, investments are held at cost less, where appropriate, provision for impairment.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired is credited to the income statement in the period of acquisition. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised. Minority interests in the net assets of consolidated subsidiaries are identified separately from the group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

#### *Associates*

An associate is an entity over which the group, either directly or indirectly, is in a position to exercise significant influence by participating in, but not controlling, the financial and operating policies of the entity. Associates are accounted for using the equity method. Losses of an associate in excess of the group's interest in the associate are not recognised, except to the extent that the group has incurred obligations in respect of the associate. Unrealised profits and losses recognised by the group on transactions with an associate are eliminated to the extent of the group's interest in the associate concerned.

#### *Joint ventures*

Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture income, expenses, assets, liabilities and cashflows are included in the consolidated financial statements on a proportionate consolidation basis using the same accounting methods as adopted for subsidiaries.

### **Non-current assets held for sale**

Non-current assets (and disposal groups comprising assets held for sale and the associated liabilities) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets (and disposal groups) are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

### **Intangible assets**

#### *Goodwill*

Goodwill arising on consolidation is recognised as an asset.

Following initial recognition, goodwill is subject to impairment reviews, at least annually, and measured at initial value less accumulated impairment losses. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, or jointly controlled entity, the attributable amount of goodwill is included in the determination of the gain or loss on disposal.

## Accounting policies (continued)

### Intangible assets (continued)

#### *Goodwill (continued)*

Goodwill written-off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

#### *Other intangible assets*

Other intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives. The carrying amount is reduced by any provision for impairment where necessary.

On a business combination, as well as recording separable intangible assets already recognised in the balance sheet of the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the acquisition balance sheet at fair value.

Internal expenditure is capitalised as internally generated intangibles only if it meets the criteria of IAS 38 'Intangible Assets'.

Amortisation periods for categories of intangible assets are:

- Computer software 3 to 10 years; and
- Other intangible assets 2 to 20 years.

### Property, plant and equipment

Property, plant and equipment comprises 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).

#### *Water and wastewater 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. Amounts incurred in maintaining the operating capability of the network in accordance with defined standards of service are expensed in the year in which the expenditure is incurred. Infrastructure assets are depreciated by writing-off their deemed cost, less the estimated residual value, evenly over their useful lives, which range from 15 to 300 years.

Employee costs incurred in implementing the capital schemes of the group are capitalised within infrastructure assets.

#### *Other assets*

All other property, plant and equipment is stated at historical cost less accumulated depreciation.

Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Freehold land and assets in the course of construction are not depreciated. Other assets are depreciated by writing-off their cost less their estimated residual value evenly over their estimated useful lives, based upon management's judgement and experience, which are principally as follows:

- Buildings 30 to 60 years;
- Operational assets 5 to 80 years; and
- Fixtures, fittings, tools and equipment 3 to 40 years.

Depreciation methods, residual values and useful lives are reassessed annually and, if necessary, changes are accounted for prospectively.

## Accounting policies (continued)

### Property, plant and equipment (continued)

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

### Impairment of tangible and intangible assets excluding goodwill

Intangible assets with definite useful lives and property, plant and equipment are reviewed for impairment at each reporting date to determine whether there is any indication that those assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cashflows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cashflows, discounted on a pre-tax basis, using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cashflows have not been adjusted.

If the recoverable amount of an asset (or cash generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash generating unit) is reduced to its recoverable amount. Impairment losses in respect of non-current assets are recognised in the income statement within operating costs.

Where an impairment loss subsequently reverses, the reversal is recognised in the income statement and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

### Financial instruments

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

#### *Cash and short-term deposits*

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

#### *Financial investments*

Investments (other than interests in associates, subsidiaries, joint ventures and fixed deposits) are initially measured at fair value, including transaction costs. Investments are classified as available for sale in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' 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.

#### *Trade receivables*

Trade receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost, less any impairment for irrecoverable amounts. Estimated irrecoverable amounts are based upon historical experience of the receivables balance.

#### *Trade payables*

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

#### *Financial liabilities and equity*

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

## Accounting policies (continued)

### Financial instruments (continued)

#### *Equity instruments*

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

#### *Borrowings*

Bonds, bank loans and overdrafts are usually 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 income statement 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, or in a fair value hedge.

#### *Financial 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 group 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 group's documented risk management strategy. Where applicable, hedge accounting will be applied.

#### *Derivative financial instruments and hedge accounting*

Interest rate swap agreements and financial futures are used to manage interest rate exposure, while the group enters into cross currency swaps to manage its exposure to fluctuations in foreign exchange rates. The group 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 income statement within finance expense as they arise, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity.

#### *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 the income statement. Gains or losses from remeasuring the derivative are recognised in the income statement.

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 income statement within finance expense.

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 IAS 39, or where the hedge designation is revoked. The cumulative fair value adjustment on the hedged instrument is frozen at the date of ineffectiveness, or the date the designation is revoked and is amortised to the income statement based upon a recalculated effective interest rate through to maturity.

#### *Cashflow hedges*

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cashflows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement.

Hedge accounting is discontinued when the hedging instrument is sold, terminated or exercised, where the hedge relationship no longer meets the criteria for hedge accounting in accordance with IAS 39, or where the hedge designation is revoked. 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.

## Accounting policies (continued)

### Financial instruments (continued)

#### *Net investment hedges*

Exchange differences arising from the translation of net investments in foreign operations are recognised directly in equity. Gains and losses on those hedging instruments (which include foreign currency forward contracts) designated as hedges of net investments in foreign operations are recognised in equity to the extent that the hedging relationships are effective. These amounts are included in foreign exchange adjustments within the statement of recognised income and expense. Gains and losses relating to hedge ineffectiveness are recognised immediately in the income statement for the period. Gains and losses accumulated in the exchange reserve are included in the income statement when the foreign operations are disposed of.

### Foreign currency translation

#### *Transactions and balances*

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange applicable on the balance sheet date. Gains and losses arising on retranslation are included in net profit or loss for the period. Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity.

In order to hedge its exposure to certain foreign exchange risks, the group enters into forward contracts, options and other derivative instruments (see derivative financial instruments and hedge accounting).

#### *Group companies*

On consolidation, the balance sheets of overseas subsidiaries and joint ventures (none of which has the currency of a hyperinflationary economy) are translated into sterling at exchange rates applicable at the balance sheet date. The income statements are translated into sterling using the average rate unless exchange rates fluctuate significantly in which case the exchange rate at the date the transaction occurred is used. Exchange differences resulting from the translation of such balance sheets at rates ruling at the beginning and end of the period, together with the differences between income statements translated at average rates and rates ruling at the period end, are dealt with as movements on the group's cumulative exchange reserve, a separate component of equity. Such translation differences are recognised as income or expense in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of implementation of IFRS 3 'Business Combinations' (1 April 1999) as sterling denominated assets and liabilities.

### 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 income statement 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.

### Long-term contract accounting

Where the outcome of a long-term contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date, as measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a long-term contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

## Accounting policies (continued)

### Long-term contract accounting (continued)

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

### Taxation

The taxation expense represents the sum of current taxation and deferred taxation.

#### *Current taxation*

Current taxation, including UK corporation tax and foreign tax, is based upon the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

#### *Deferred taxation*

Deferred taxation is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred taxation liabilities are provided, using the liability method, on all taxable temporary differences at the balance sheet date. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred taxation liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the temporary timing differences are expected to reverse based upon tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

The carrying amount of deferred taxation assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred taxation is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the deferred taxation is also dealt with in equity.

### Employee benefits

#### *Retirement benefit obligations*

The group operates a number of defined benefit pension schemes, which are independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the schemes are carried out as determined by the pension scheme trustees using the projected unit credit method at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

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

The cost of providing pension benefits to employees relating to the current year's service is included within the income statement within employee costs. The difference between the expected return on scheme assets and interest on scheme liabilities is included within the income statement within investment income.

All actuarial gains and losses are recognised outside the income statement in retained earnings and presented in the statement of recognised income and expense.

## Accounting policies (continued)

### Employee benefits (continued)

#### *Retirement benefit obligations (continued)*

In addition, the group also operates defined contribution pension schemes. Payments are charged as employee costs as they fall due. The group has no further payment obligations once the contributions have been paid.

#### *Share-based compensation arrangements*

The group operates equity-settled, share-based compensation plans. In accordance with the transitional provisions, IFRS 2 'Share-based Payments' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

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

At each balance sheet date, the group revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

### Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Environmental expenditure that relates to current or future revenues is expensed or capitalised as appropriate. Expenditure that relates to an existing condition caused by past operations that does not contribute to current or future earnings is expensed. Liabilities for environmental remediation costs are recognised when there is a legal or constructive obligation, environmental assessments indicate that clean up is probable, and the associated costs can be reliably estimated.

### Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided. Where relevant, this includes an estimate of the sales value of units supplied to customers between the date of the last meter reading and the period end, exclusive of value added tax and foreign sales tax.

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

### Grants and contributions

Grants and contributions receivable in respect of property, plant and equipment are treated as deferred income, which is credited to the income statement over the estimated economic lives of the related assets.

### Leases

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.

## Accounting policies (continued)

### Leases (continued)

#### *Finance leases*

Finance leases are capitalised in the consolidated 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 nature, the finance element is written-off to the income statement 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 written-off to the income statement 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.

#### *Operating leases*

Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

### Inventories

Inventories are stated at cost less any provision necessary to recognise damage and obsolescence. Finished goods and goods for resale are stated at the lower of cost; comprising, where applicable, direct materials, direct labour costs and appropriate overheads incurred in bringing them to their present location and condition, and net realisable value.

Properties held for resale are included at the lower of cost and net realisable value. Cost includes the cost of acquiring and developing the sites.

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

### Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group 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 amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting periods presented.

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

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

#### *Carrying value of property, plant and equipment*

The estimated useful economic lives of property, plant and equipment (PPE) are based upon 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 PPE investment to the group, 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 group is required to evaluate the carrying values of PPE for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make subjective judgements concerning the cashflows, growth rates and discount rates of the cash generating units under review.

## Accounting policies (continued)

### Critical accounting judgements and key sources of estimation uncertainty (continued)

#### *Revenue recognition*

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

United Utilities Water PLC raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the receivable billed is dependent 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 group recognises revenue for unbilled amounts based upon estimated usage from the last billing through to the end of the financial year. The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

For the group's other businesses, revenue is recognised in line with activity and performance, normally using amounts specified in contractual obligations and when recoverability is reasonably assured. In general:

- variable revenues, for example, revenues dependent upon customer volumes in the period, are recognised only when those variable activities are performed;
- performance incentives are recognised in revenue only to the extent that it is probable that the related economic benefits will flow to the group; and
- revenue received in advance of performance is recognised as deferred income. When performance occurs, the deferred income is released and simultaneously reported as revenue.

A breakdown of revenues by segment is contained in note 2 to the consolidated financial statements.

#### *Provision for doubtful receivables*

At each balance sheet date, the company and each of its subsidiaries evaluate the recoverability of trade receivables and record provisions for doubtful receivables based upon experience. These provisions are based upon, amongst other things, customer category and consideration of actual collection history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

#### *Accounting for provisions and contingencies*

The group is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The group routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed in note 29, unless the possibility of transferring economic benefits is remote.

## Accounting policies (continued)

### Critical accounting judgements and key sources of estimation uncertainty (continued)

#### *Retirement benefits*

The group operates a number of defined benefit schemes, one of which has a defined contribution section, which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based upon the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based upon information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 19. 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 group'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 income statement. This has the potential to introduce considerable volatility to both the income statement and balance sheet.

Therefore, where feasible, the group has taken advantage of the various provisions under IAS 39 to designate borrowings at fair value through the income statement or equity to reduce this volatility and better represent the economic hedges that exist between the group'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 income statement, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity. The group 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 group's level of borrowings.

Designated borrowings and derivatives valued at fair value are valued using a discounted cashflow valuation model. This model calculates the zero coupon curves for the applicable currency as at the balance sheet date and uses these to determine future floating cashflows. Future fixed and floating cashflows are discounted using discount factors derived from the same zero coupon curves adjusted for credit where appropriate. Cashflows denominated in foreign currencies are converted into sterling at the spot exchange rate observed at the balance sheet date.

The valuation of debt designated as being within a fair value hedged relationship is calculated based upon the risk being hedged in line with IAS 39. The group looks to hedge cashflows which represents its floating rate exposure, and it is this portion which is used in the valuation model.

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 upon indicative pricing data.

#### *Taxation*

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions.

## Accounting policies (continued)

### Recently issued accounting pronouncements

#### *International Financial Reporting Standards*

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

The directors anticipate that the adoption of the following standards and interpretations will have a material impact on the group's financial statements:

- IAS 23 'Borrowing Costs – Revised standard'. On 29 March 2007, the International Accounting Standards Board (IASB) issued a revised IAS 23 'Borrowing Costs'. The main change from the previous version is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to prepare for use or sale. The revised standard is effective for periods commencing on or after 1 January 2009. The group is, therefore, required to capitalise borrowing costs as part of the cost of qualifying assets from 1 April 2009. The amendment was endorsed by the EU on 10 December 2008; and
- IFRS 3 'Business Combinations – Revised standard', issued in January 2008, is effective for periods commencing on or after 1 July 2009 but has not yet been endorsed by the EU. This will have a material impact on the group's financial statements only if it enters into any relevant transactions in the future.

The directors anticipate that the adoption of the following standards and interpretations will have no material impact on the group's financial statements:

- IAS 32 'Financial Instruments: Presentation – Amendment' and IAS 1 'Presentation of Financial Statements – Amendment', issued in February 2008, are effective for periods commencing on or after 1 January 2009 and were endorsed by the EU on 21 January 2009;
- IFRS 2 'Share-based Payment – Amendment', issued in January 2008, is effective for periods commencing on or after 1 January 2009 and was endorsed by the EU on 16 December 2008;
- IFRS 7 'Financial Instruments: Disclosures – Amendment', issued in March 2009, is effective for periods commencing on or after 1 January 2009 but has not yet been endorsed by the EU;
- IFRS 8 'Operating Segments', issued in November 2006, is effective for periods commencing on or after 1 January 2009 and was endorsed by the EU on 21 November 2007;
- IFRIC 12 'Service Concession Arrangement', issued in November 2006, is effective for periods commencing on or after 1 January 2008 and was endorsed by the EU on 26 March 2009 with the requirement to apply to periods starting after 29 March 2009; and
- IFRIC 16 'Hedges of a Net Investment in a Foreign Operation', issued in July 2008, is effective for periods commencing on or after 1 October 2008 but has not yet been endorsed by the EU.

Interpretations in issue but not considered relevant to the activities of the group are as follows:

- IFRS 1 'First-time Adoption of International Financial Reporting Standards – Amendment' and IAS 27 'Consolidated and Separate Financial Statements – Amendment', issued in May 2008, are effective for periods commencing on or after 1 July 2009 and were endorsed by the EU on 23 January 2009;
- IAS 27 'Consolidated and Separate Financial Statements – Revised standard', issued in January 2008, is effective for periods commencing on or after 1 July 2009 but has not yet been endorsed by the EU;

## Accounting policies (continued)

### Recently issued accounting pronouncements (continued)

#### *International Financial Reporting Standards (continued)*

- IAS 39 'Financial Instruments: Recognition and Measurement – Amendment', issued in July 2008, is effective for periods commencing on or after 1 July 2009 but has not yet been endorsed by the EU;
- IFRIC 9 'Reassessment of Embedded Derivatives – Amendment' and IAS 39 'Financial Instruments: Recognition and Measurement – Amendment', issued in March 2009, are effective for periods commencing on or after 1 July 2008 but have not yet been endorsed by the EU;
- IFRIC 13 'Customer Loyalty Programmes', issued in June 2007, is effective for periods commencing on or after 1 July 2008 and was endorsed by the EU on 16 December 2008;
- IFRIC 15 'Agreements for the Construction of Real Estate', issued in July 2008, is effective for periods commencing on or after 1 January 2009 but has not yet been endorsed by the EU;
- IFRIC 17 'Distributions of Non-cash Assets to Owners', issued in November 2008, is effective for periods commencing on or after 1 July 2009 but has not yet been endorsed by the EU; and
- IFRIC 18 'Transfer of Assets from Customers', issued in January 2009, is effective for periods commencing on or after 1 July 2009 but has not yet been endorsed by the EU.

## Notes to the financial statements

### 1. Total revenue

	<b>Continuing operations 2009 £m</b>	Continuing operations 2008 £m	Discontinued operations 2008 £m	Total 2008 £m
Provision of goods and services (see note 2)	2,434.7	2,362.9	234.7	2,597.6
Dividend income (see note 4)	12.4	11.2	-	11.2
Investment income (see note 5)	106.0	146.7	0.5	147.2
	<u>2,553.1</u>	<u>2,520.8</u>	<u>235.2</u>	<u>2,756.0</u>

No revenue was derived from exchanges of goods or services during the year ended 31 March 2009 (2008: £nil).

### 2. Segment reporting

The group's revenue predominantly arises from the provision of services.

For management purposes, the group is organised into two principal operating divisions, being regulated and non-regulated activities. These divisions form the basis on which the primary segment information is reported.

The regulated activities segment includes the regulated results of United Utilities Water PLC.

The non-regulated activities segment includes the group's utility outsourcing contracts in the United Kingdom and overseas.

In addition, the other activities segment includes the results of United Utilities Property Solutions Limited, United Utilities PLC and other group holding companies.

Trading between segments is carried out on an arm's-length basis and transactions are priced accordingly. External market prices are used where available; where not available, margins generated are compared to those generated from external sales and adjusted where necessary.

<b>Year ended 31 March 2009</b>	<b>Regulated activities £m</b>	<b>Non- regulated activities £m</b>	<b>Other activities £m</b>	<b>Group £m</b>
<i>Continuing operations</i>				
Total revenue	1,499.5	919.3	22.4	2,441.2
Inter-segment revenue	(0.9)	(0.1)	(5.5)	(6.5)
<b>External revenue</b>	<u>1,498.6</u>	<u>919.2</u>	<u>16.9</u>	<u>2,434.7</u>
<b>Segmental operating profit/(loss)</b>	<u>678.4</u>	<u>69.1</u>	<u>(12.3)</u>	<u>735.2</u>
Investment income				106.0
Finance expense				(272.5)
<b>Profit before taxation</b>				<u>568.7</u>
Taxation				(360.0)
<b>Profit for the year from continuing operations</b>				<u>208.7</u>

## Notes to the financial statements (continued)

### 2. Segment reporting (continued)

	Regulated activities £m	Non- regulated activities £m	Other activities £m	Group £m
Year ended 31 March 2008				
<i>Continuing operations</i>				
Total revenue	1,416.3	949.2	41.3	2,406.8
Inter-segment revenue	(2.1)	(33.2)	(8.6)	(43.9)
<b>External revenue</b>	<b>1,414.2</b>	<b>916.0</b>	<b>32.7</b>	<b>2,362.9</b>
<b>Segmental operating profit</b>	<b>611.6</b>	<b>50.6</b>	<b>1.0</b>	<b>663.2</b>
Investment income				146.7
Finance expense				(331.6)
<b>Profit before taxation</b>				<b>478.3</b>
Taxation				(62.0)
<b>Profit for the year from continuing operations</b>				<b>416.3</b>
Year ended 31 March 2009				
<i>Discontinued operations</i>				
External revenue			-	-
<b>Segmental operating loss</b>			<b>(1.2)</b>	<b>(1.2)</b>
Year ended 31 March 2008				
	Regulated activities £m	Non- regulated activities £m	Telecoms £m	Group £m
<i>Discontinued operations</i>				
Total revenue	223.7	32.6	-	256.3
Inter-segment revenue	-	(21.6)	-	(21.6)
<b>External revenue</b>	<b>223.7</b>	<b>11.0</b>	<b>-</b>	<b>234.7</b>
<b>Segmental operating profit</b>	<b>153.3</b>	<b>0.7</b>	<b>4.5</b>	<b>158.5</b>

For further information on the group's discontinued operations see note 8.

## Notes to the financial statements (continued)

### 2. Segment reporting (continued)

Year ended 31 March 2009		Regulated activities £m	Non-regulated activities £m	Other activities £m	Unallocated £m	Group £m
<b>Other information</b>						
Capital additions		622.6	42.8	0.2	-	665.6
Depreciation and amortisation		236.2	27.2	0.1	-	263.5
<b>Balance sheet</b>						
Segment assets		8,495.1	695.7	254.2	1,784.0	11,229.0
Segment liabilities		(650.6)	(318.2)	(46.1)	(7,346.8)	(8,361.7)
<hr/>						
Year ended 31 March 2008	Regulated £m	Non-regulated £m	Other activities £m	Dis-continued operations £m	Unallocated £m	Group £m
<b>Other information</b>						
Capital additions		706.0	61.6	0.1	166.8	934.5
Depreciation and amortisation		222.9	24.9	0.4	-*	248.2
<b>Balance sheet</b>						
Segment assets		7,752.8	695.6	73.6	-	10,336.4
Segment liabilities		(593.3)	(310.6)	(113.7)	-	(7,126.4)
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\* Depreciation and amortisation in respect of the group's discontinued operations is disclosed in note 8.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise interest bearing cash and borrowings and taxation related assets and liabilities.

Of the group's consolidated revenue and net assets for continuing operations, greater than 90 per cent of revenue is derived from customers located in the United Kingdom and greater than 90 per cent of the net assets are located in the United Kingdom, for both of the years ended 31 March 2009 and 31 March 2008 and, hence, no geographical analysis is presented.

### 3. Directors and employees

#### Directors' remuneration

	2009 £m	2008 £m
Salaries	1.6	1.6
Benefits	0.1	0.4
Bonus	1.0	1.4
	<hr/>	<hr/>
	2.7	3.4
	<hr/>	<hr/>

Included within the above is salary of £0.8 million (2008: £0.7 million) and bonus of £0.5 million (2008: £0.7 million) in respect of the highest paid director.

## Notes to the financial statements (continued)

### 3. Directors and employees (continued)

#### Directors' remuneration (continued)

Benefits of £0.1 million (2008: £0.4 million) include £nil (2008: £0.3 million) in respect of compensation for loss of office.

All non-executive directors, including the Chairman, sit on the board of United Utilities Group PLC, and their fees are not re-charged. Fees to non-executive directors for the year were £0.6 million (2008: £0.6 million). Further information on non-executive directors is included in the financial statements of United Utilities Group PLC.

#### Remuneration of key management personnel

	2009 £m	2008 £m
Salaries and short-term benefits	5.0	5.6
Post-employment benefits	0.7	0.6
Share-based payments	-	0.1
	5.7	6.3

Salaries and short-term employee benefits include £nil (2008: £0.3 million) in respect of compensation for loss of office. Key management personnel comprises all directors and certain senior managers who are members of the executive leadership team.

#### Employee benefits expense (including directors)

	2009 £m	Group 2008 £m	2009 £m	Company 2008 £m
<b>Continuing operations</b>				
Wages and salaries	328.1	308.9	32.8	16.2
Social security costs	26.8	24.7	3.5	1.9
Post-employment benefits	60.4	48.1	4.1	1.8
	415.3	381.7	40.4	19.9
Capital schemes and charges against provisions	(68.1)	(64.2)	-	-
<b>Employee benefits expense attributable to continuing operations</b>	347.2	317.5	40.4	19.9
<b>Discontinued operations</b>				
Wages and salaries	-	10.2	-	-
Social security costs	-	0.8	-	-
Post-employment benefits	-	7.0	-	-
	-	18.0	-	-
Capital schemes and charges against provisions	-	(1.9)	-	-
<b>Employee benefits expense attributable to discontinued operations</b>	-	16.1	-	-
	347.2	333.6	40.4	19.9
Less: employee benefits expense attributable to joint ventures	(9.2)	(7.1)	-	-
<b>Total employee benefits expense</b>	338.0	326.5	40.4	19.9

No directors had any interest in shares at 31 March 2009. Further information regarding directors' interests in shares at 31 March 2008 is included in the financial statements of United Utilities Group PLC.

## Notes to the financial statements (continued)

### 3. Directors and employees (continued)

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

	<b>2009</b>	2008
	<b>number</b>	number
<b>Group</b>		
<i>Continuing operations</i>		
Regulated activities	3,925	3,888
Non-regulated activities	4,364	4,517
Other activities	677	268
	<u>8,966</u>	<u>8,673</u>
<b>Group</b>		
<i>Discontinued operations</i>		
United Utilities Electricity	-	57
Industrial liquid waste	-	34
Facilities management	-	145
	<u>8,966</u>	<u>8,909</u>

The average number of employees during the year employed by the company was 624 (2008: 198).

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

	<b>Continuing</b>	Continuing	Dis-	Total
	<b>operations</b>	operations	continued	2008
	<b>2009</b>	2008	2008	2008
	<b>£m</b>	£m	£m	£m
<b>Group</b>				
Defined benefit pension expense charged to operating profit (see note 19)	39.8	44.1	6.3	50.4
Defined contribution pension costs (see note 19)	20.6	4.0	0.7	4.7
	<u>60.4</u>	<u>48.1</u>	<u>7.0</u>	<u>55.1</u>
			<b>2009</b>	2008
			<b>£m</b>	£m
<b>Company</b>				
Defined benefit pension expense charged to operating profit (see note 19)			1.9	0.8
Defined contribution pension costs (see note 19)			2.2	1.0
			<u>4.1</u>	<u>1.8</u>

## Notes to the financial statements (continued)

### 4. Operating profit

The following items have been (credited)/charged to the income statement in arriving at the group's operating profit from continuing operations and the (loss)/profit from discontinued operations:

	<b>Continuing operations 2009 £m</b>	Continuing operations 2008 £m	Dis- continued operations 2008 £m	Re- presented Total 2008 £m
<b>Other income</b>				
Dividend income	(12.4)	(11.2)	-	(11.2)
Loss/(profit) on disposal of property, plant and equipment	0.8	(5.7)	2.5	(3.2)
Other income	(6.9)	(4.4)	0.2	(4.2)
	<u>(18.5)</u>	<u>(21.3)</u>	<u>2.7</u>	<u>(18.6)</u>
<b>Depreciation and amortisation expense</b>				
Depreciation of property, plant and equipment:				
Owned assets (see note 10)	242.6	224.3	9.7	234.0
Under finance leases (see note 10)	1.7	1.7	-	1.7
Amortisation of other intangible assets (see note 12)	19.2	22.2	0.6	22.8
	<u>263.5</u>	<u>248.2</u>	<u>10.3</u>	<u>258.5</u>
<b>Other operating costs</b>				
Hired and contracted services	481.7	499.6	12.6	512.2
Materials	168.3	161.1	0.9	162.0
Power	87.6	70.5	1.0	71.5
Property rates	57.0	61.8	11.7	73.5
Charge for bad and doubtful receivables (see note 15)	53.6	55.8	0.2	56.0
Other operating leases payable:				
Property	4.9	2.9	0.1	3.0
Plant and equipment	3.0	1.8	-	1.8
Amortisation of government grants (see note 22)	(6.4)	(6.2)	(6.4)	(12.6)
Research and development expenses	0.9	1.2	0.5	1.7
Other	138.9	186.7	52.6	239.3
	<u>989.5</u>	<u>1,035.2</u>	<u>73.2</u>	<u>1,108.4</u>

The comparatives for the year ended 31 March 2008 have been re-presented to reflect a re-analysis of other operating costs as the directors believe this provides a fairer presentation of the nature of these costs.

During the year, the group obtained the following services from its auditors, at the costs detailed below:

	<b>2009 £m</b>	2008 £m
Statutory audit of the financial statements	0.4	0.5
Other fees to the auditors:		
Local statutory audits for subsidiaries	0.3	0.4
Other audit related	0.1	0.1
Regulatory reporting	0.4	0.2
Due diligence and transaction support	1.2	3.6
	<u>2.4</u>	<u>4.8</u>

Included in the above statutory audit fee is £50,000 in relation to the company for the year ended 31 March 2009 (2008: £50,000).

## Notes to the financial statements (continued)

### 5. Investment income

	<b>2009</b>	2008
	<b>£m</b>	£m
Interest receivable on short-term bank deposits held at amortised cost	22.6	67.8
Forward exchange gains on forward contracts	36.1	55.4
Interest receivable from ultimate parent undertaking	40.5	-
	<u>99.2</u>	<u>123.2</u>
Expected return on pension schemes' assets (see note 19)	124.3	128.6
Interest cost on pension schemes' obligations (see note 19)	(117.5)	(105.1)
Net pension interest income	<u>6.8</u>	<u>23.5</u>
	<u>106.0</u>	<u>146.7</u>

### 6. Finance expense

	<b>2009</b>	2008
	<b>£m</b>	£m
<i>Interest payable</i>		
Interest payable on borrowings held at amortised cost	243.4	285.7
Interest payable on finance leases (see note 17)	2.7	3.2
Interest payable to ultimate parent undertaking	2.1	-
	<u>248.2</u>	<u>288.9</u>
<i>Fair value losses/(gains) on debt and derivative instruments<sup>(1)</sup></i>		
Fair value hedge relationships:		
Borrowings	494.4	177.8
Designated swaps	(441.1)	(109.6)
	<u>53.3</u>	<u>68.2</u>
Hedging for trading derivatives – economic hedge	(51.6)	(78.1)
	<u>1.7</u>	<u>(9.9)</u>
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss <sup>(2)</sup>	56.5	(5.7)
Held for trading derivatives – economic hedge	(161.2)	(26.3)
	<u>(104.7)</u>	<u>(32.0)</u>
Held for trading derivatives – 2005-2010 regulatory hedges	68.8	24.5
Held for trading derivatives – 2010-2015 regulatory hedges	31.2	-
Net payments on swaps and debt under fair value option	15.7	49.5
Held for trading derivatives – other <sup>(3)</sup>	20.4	11.2
Other	(8.8)	(0.6)
	<u>127.3</u>	<u>84.6</u>
Net fair value losses/(gains) on debt and derivative instruments <sup>(4)</sup>	<u>24.3</u>	<u>42.7</u>
Total finance expense	<u>272.5</u>	<u>331.6</u>

#### Notes:

- (1) Fair value losses/(gains) on debt and derivative instruments includes foreign exchange losses of £352.0 million (2008: £153.6 million losses), excluding those on instruments measured at fair value through profit or loss. These losses will be largely offset by fair value gains on derivatives.
- (2) Includes £76.6 million gains (2008: £28.2 million gains) 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 the expired THUS Group plc option in 2008, joint venture swaps and other economic hedge derivatives relating to debt held at amortised cost.
- (4) Includes £8.3 million (2008: £41.7 million) interest on swaps and debt under fair value option.

## Notes to the financial statements (continued)

### 7. Taxation

	<b>Continuing operations 2009 £m</b>	Continuing operations 2008 £m	Dis- continued operations 2008 £m	Total 2008 £m
<b>Current taxation:</b>				
UK corporation tax	157.8	108.9	28.4	137.3
Foreign tax	2.1	2.7	-	2.7
Prior year adjustments	(10.0)	(23.0)	(0.1)	(23.1)
	<u>149.9</u>	<u>88.6</u>	<u>28.3</u>	<u>116.9</u>
<b>Deferred taxation (see note 20):</b>				
Current year	(0.5)	37.5	12.4	49.9
Prior year adjustments	4.2	17.6	(4.6)	13.0
	<u>3.7</u>	<u>55.1</u>	<u>7.8</u>	<u>62.9</u>
Abolition of industrial buildings allowances	206.4	-	-	-
Change in taxation rate	-	(81.7)	(21.7)	(103.4)
	<u>210.1</u>	<u>(26.6)</u>	<u>(13.9)</u>	<u>(40.5)</u>
Total tax charge for the year	<u><u>360.0</u></u>	<u><u>62.0</u></u>	<u><u>14.4</u></u>	<u><u>76.4</u></u>

The tables below reconcile the notional tax charge at the UK corporation tax rate to the effective tax rate for the year:

	<b>Continuing operations</b>		<b>Discontinued operations</b>		<b>Total</b>	
	<b>2009 £m</b>	<b>2009 %</b>	<b>2009 £m</b>	<b>2009 %</b>	<b>2009 £m</b>	<b>2009 %</b>
Profit/(loss) before taxation	568.7		(1.2)		567.5	
Tax at the UK corporation tax rate of 28 per cent (2008: 30 per cent)	159.2	28.0	(0.3)	28.0	158.9	28.0
Adjustments in respect of prior periods	(5.8)	(1.0)	-	-	(5.8)	(1.0)
Abolition of industrial buildings allowances	206.4	36.3	-	-	206.4	36.4
Net (income)/expense not (taxable)/deductible	0.2	-	0.3	(28.0)	0.5	0.1
Total tax charge and effective tax rate for the year	<u><u>360.0</u></u>	<u><u>63.3</u></u>	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>360.0</u></u>	<u><u>63.5</u></u>

	Continuing operations		Discontinued operations		Total	
	2008 £m	2008 %	2008 £m	2008 %	2008 £m	2008 %
Profit before taxation	478.3		141.9		620.2	
Tax at the UK corporation tax rate of 30 per cent (2007: 30 per cent)	143.5	30.0	42.6	30.0	186.1	30.0
Adjustments in respect of prior periods	(5.4)	(1.1)	(4.7)	(3.3)	(10.1)	(1.6)
Change in taxation rate	(81.7)	(17.1)	(21.7)	(15.3)	(103.4)	(16.7)
Net (income)/expense not (taxable)/deductible	5.6	1.2	(1.8)	(1.3)	3.8	0.6
Total tax charge and effective tax rate for the year	<u><u>62.0</u></u>	<u><u>13.0</u></u>	<u><u>14.4</u></u>	<u><u>10.1</u></u>	<u><u>76.4</u></u>	<u><u>12.3</u></u>

## Notes to the financial statements (continued)

### 7. Taxation (continued)

Following Royal Assent of the 2008 Finance Act on 21 July 2008, the abolition of industrial buildings allowances was formally enacted. The financial impact as a consequence of this legislation is a one-off deferred tax charge of £206.4 million, which is included in the current year deferred tax charge; however the cash impact will be spread over a period of approximately 20 years.

A tax credit of £5.8 million (2008: £5.4 million) arose in the year in relation to prior year tax returns for continuing operations.

A deferred tax credit of £81.7 million on continuing operations arose in the prior year due to the change in taxation rate due to the reduction in the mainstream corporation tax rate from 30 per cent to 28 per cent from 1 April 2008.

### 8. Discontinued operations

During the prior year, in line with its declared strategy of concentrating on its core skills of managing water, wastewater, electricity and gas networks, the group completed the disposal of United Utilities Electricity (UUE) to North West Electricity Networks Limited on 19 December 2007 for a total enterprise value of £1,782 million.

The group continues to look for opportunities to apply its core skills in its non-regulated business where it identifies opportunities to generate additional shareholder value with little impact on the risk profile of the group. In line with this strategy, the group sold its industrial liquid waste and facilities management operations and made its final exit from the telecoms sector during the prior year. On 26 October 2007, the group sold its industrial liquid waste operations to Group Tradebe for consideration of £3.7 million and on 22 February 2008, the group completed the sale of its facilities management operations to Europa Facility Holdings Limited for consideration of £9.0 million.

The group sold its 22.63 per cent stake in THUS Group plc on 19 June 2007 for consideration of £75.8 million, which completed United Utilities' exit from the telecoms sector. The sale is treated as an adjustment to consideration arising on the disposal of Your Communications and, as such, both the loss on disposal and the group's share of THUS' results prior to the disposal are disclosed within discontinued operations in 2008.

The results of UUE, the group's industrial liquid waste and facilities management operations and its share of results from its associate have been disclosed, along with the profit/(loss) on disposal, as discontinued operations in the group's financial statements in 2008. The detailed trading results and the profit/(loss) on disposal of each discontinued operation are shown below. Cashflows in relation to discontinued operations are separately disclosed in the group's cashflow statement in 2008.

Revenue from the discontinued operations was derived principally from customers located in the United Kingdom, the related net assets were also primarily located in the United Kingdom.

There is no tax charged on the profits resulting from the disposal of the discontinued operations during the year ended 31 March 2008 as these were tax exempt sales of shares.

	<b>2009</b>	2008
	<b>£m</b>	£m
United Utilities Electricity	(1.2)	493.0
Industrial liquid waste	-	(5.0)
Facilities management	-	10.4
Telecoms (including loss on disposal of THUS Group plc shares of £10.0 million)	-	(5.5)
<b>(Loss)/profit for the year/period from discontinued operations</b>	<b>(1.2)</b>	<b>492.9</b>

## Notes to the financial statements (continued)

### 8. Discontinued operations (continued)

	United Utilities Electricity Period ended 19 December 2007 £m	Industrial liquid waste Period ended 26 October 2007 £m	Facilities management Period ended 22 February 2008 £m
<b>Revenue</b>			
External sales	223.7	5.3	5.7
Intra-group sales	-	-	21.6
<b>Total revenue</b>	223.7	5.3	27.3
Depreciation and amortisation	(10.0)	(0.2)	(0.1)
Other operating expenses	(60.4)	(5.2)	(26.4)
<b>Operating profit/(loss)</b>	153.3	(0.1)	0.8
Investment income and finance expense	(17.1)	-	0.5
<b>Profit/(loss) before taxation</b>	136.2	(0.1)	1.3
Taxation on profit/(loss)	(14.4)	-	-
<b>Profit/(loss) for the period from discontinued operations</b>	121.8	(0.1)	1.3
Profit/(loss) on disposal of discontinued operations	371.2	(4.9)	9.1
<b>Total profit/(loss) for the period from discontinued operations</b>	493.0	(5.0)	10.4

Profit before taxation from facilities management includes profit generated from intercompany trading of £0.2 million in the period ended 22 February 2008.

The net assets/(liabilities) at the date of disposal were as follows:

	United Utilities Electricity 19 December 2007 £m	Industrial liquid waste 26 October 2007 £m	Facilities management 22 February 2008 £m
Property, plant and equipment	1,957.4	4.3	0.2
Goodwill	-	2.9	-
Other intangible assets	23.3	-	-
Trade and other receivables	166.2	2.3	7.6
Cash and short-term deposits	-	-	1.2
Non-current liabilities	(1,339.7)	-	-
Trade and other payables	(115.9)	(1.6)	(8.3)
Retirement benefit surplus/(obligations)	31.5	-	(1.0)
<b>Net assets/(liabilities)</b>	722.8	7.9	(0.3)
Transaction costs	46.0	0.7	0.2
Profit/(loss) on disposal	371.2	(4.9)	9.1
<b>Total fair value of consideration satisfied by cash</b>	1,140.0 <sup>(1)</sup>	3.7	9.0

**Note:**

(1) Total fair value consideration of United Utilities Electricity comprised cash of £1,140.0 million. The enterprise value of £1,782.0 million incorporates cash consideration received added to the market value of the debt disposed of, which at the date of disposal totalled £642.0 million.

## Notes to the financial statements (continued)

### 9. Dividends

	<b>2009</b>	2008
	<b>£m</b>	£m
Amounts recognised as distributions to equity holders in the year comprise:		
<b>Ordinary shares</b>		
Final dividend for the year ended 31 March 2008 at 31.47 pence per share (2007: 30.30 pence)	277.4	266.6
First interim dividend for the year ended 31 March 2009 at 11.34 pence per share (2008: 15.20 pence)	100.0	133.8
Second interim dividend for the year ended 31 March 2009 at 8.22 pence per share (2008: nil pence)	72.5	-
	<hr/> 449.9	<hr/> 400.4
Proposed dividend for the year ended 31 March 2009 at 17.15 pence per share (2008: 31.47 pence)	<hr/> 151.2	<hr/> 277.4

The proposed final dividends for the years ended 31 March 2009 and 31 March 2008 were subject to approval by equity holders of United Utilities PLC and hence were not included as liabilities in the consolidated financial statements at 31 March 2009 and 31 March 2008 respectively.

## Notes to the financial statements (continued)

### 10. Property, plant and equipment

	Land and buildings £m	Infra- structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
<b>Group Cost</b>						
At 1 April 2007	346.8	3,386.9	6,310.4	457.8	731.0	11,232.9
Additions	7.0	79.3	193.0	72.5	554.7	906.5
Transfers	6.3	73.7	106.6	14.4	(201.0)	-
Disposals	(142.1)	(3.7)	(2,477.2)	(30.5)	(188.6)	(2,842.1)
Currency translation differences	0.7	26.1	-	0.3	1.3	28.4
At 31 March 2008	218.7	3,562.3	4,132.8	514.5	897.4	9,325.7
Additions	4.0	76.0	102.9	71.1	372.7	626.7
Transfers	5.0	86.5	215.4	28.4	(335.3)	-
Disposals	(6.8)	(3.1)	(37.1)	(22.5)	-	(69.5)
Currency translation differences	0.8	7.5	-	0.4	1.3	10.0
<b>At 31 March 2009</b>	221.7	3,729.2	4,414.0	591.9	936.1	9,892.9
<b>Accumulated depreciation</b>						
At 1 April 2007	109.6	118.2	1,891.9	218.6	-	2,338.3
Charge for the year	8.7	31.8	151.0	44.2	-	235.7
Disposals	(48.5)	(3.7)	(786.8)	(11.0)	-	(850.0)
Currency translation differences	0.1	11.7	-	(1.9)	-	9.9
At 31 March 2008	69.9	158.0	1,256.1	249.9	-	1,733.9
Charge for the year	7.2	38.6	149.3	49.2	-	244.3
Disposals	(6.8)	(3.1)	(37.1)	(17.9)	-	(64.9)
Currency translation differences	0.2	2.2	(0.3)	0.3	-	2.4
<b>At 31 March 2009</b>	70.5	195.7	1,368.0	281.5	-	1,915.7
<b>Net book value at 31 March 2009</b>	151.2	3,533.5	3,046.0	310.4	936.1	7,977.2
Net book value at 31 March 2008	148.8	3,404.3	2,876.7	264.6	897.4	7,591.8

The carrying amount of the group's operational assets includes an amount of £nil (2008: £64.4 million) in respect of assets held under finance leases.

At 31 March 2009, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £312.5 million (2008: £485.2 million).

## Notes to the financial statements (continued)

### 10. Property, plant and equipment (continued)

<b>Company</b>	Fixtures, fittings, tools and equipment £m
<b>Cost</b>	
At 1 April 2007, 31 March 2008 and 31 March 2009	4.8
<b>Accumulated depreciation</b>	
At 1 April 2007	4.2
Charge for the year	0.1
At 31 March 2008	4.3
Charge for the year	0.1
<b>At 31 March 2009</b>	<b>4.4</b>
<b>Net book value at 31 March 2009</b>	<b>0.4</b>
Net book value at 31 March 2008	0.5

The company had no contractual commitments for the acquisition of property, plant and equipment at 31 March 2009 or at 31 March 2008.

### 11. Goodwill

<b>Group</b>	£m
<b>Cost</b>	
At 1 April 2007	5.0
Disposals (see note 8)	(2.9)
Currency translation differences	0.2
At 31 March 2008	2.3
Currency translation differences	0.3
<b>At 31 March 2009</b>	<b>2.6</b>

Goodwill is subject to impairment testing annually, or more frequently if there are indications of impairment. The recoverable amounts of cash generating units (CGUs) are determined from value-in-use calculations that use amounts from approved budgets and plans for the next seven years and extrapolate cashflows for a further eight years based upon an estimated growth rate. The discount rate applied to the cashflow projections was 9.9 per cent (2008: 13.6 to 15.0 per cent). The growth rate used of nil per cent (2008: 2.4 per cent) was based upon industry growth rates, which do not exceed the long-term average growth rate.

Goodwill is allocated to the appropriate CGU according to the business segment. Goodwill was held entirely within the non-regulated activities business segment at both 31 March 2009 and 31 March 2008.

## Notes to the financial statements (continued)

### 12. Other intangible assets

Group	Computer software £m	Other £m	Total £m
<b>Cost</b>			
At 1 April 2007	228.9	18.6	247.5
Additions – internally generated	2.7	-	2.7
Additions – purchased	24.6	0.7	25.3
Disposals	(59.5)	(0.2)	(59.7)
Currency translation differences	-	2.5	2.5
At 31 March 2008	196.7	21.6	218.3
Additions – purchased	38.7	0.2	38.9
Disposals	(53.5)	(0.3)	(53.8)
Currency translation differences	-	2.8	2.8
<b>At 31 March 2009</b>	<b>181.9</b>	<b>24.3</b>	<b>206.2</b>
<b>Amortisation</b>			
At 1 April 2007	124.9	7.1	132.0
Charge for the year	21.6	1.2	22.8
Disposals	(22.7)	(0.2)	(22.9)
Currency translation differences	-	1.1	1.1
At 31 March 2008	123.8	9.2	133.0
Charge for the year	18.0	1.2	19.2
Disposals	(53.3)	-	(53.3)
Currency translation differences	-	1.2	1.2
<b>At 31 March 2009</b>	<b>88.5</b>	<b>11.6</b>	<b>100.1</b>
<b>Net book value at 31 March 2009</b>	<b>93.4</b>	<b>12.7</b>	<b>106.1</b>
Net book value at 31 March 2008	72.9	12.4	85.3

The other intangible assets category relates mainly to customer related intangibles such as customer contracts and customer lists.

At 31 March 2009, the group had entered into contractual commitments for the acquisition of other intangible assets amounting to £19.5 million (2008: £16.9 million).

The company has no other intangible assets. The company had no contractual commitments for the acquisition of other intangible assets at 31 March 2009.

## Notes to the financial statements (continued)

### 13. Investments

	Associate £m	Other investments £m	Total £m
<b>Group</b>			
At 1 April 2007	83.7	118.7	202.4
Reclassification from prepayments and accrued income	-	1.0	1.0
Disposals	(83.7)	(0.6)	(84.3)
Revaluations	-	34.9	34.9
Currency translation differences	-	1.5	1.5
At 31 March 2008	-	155.5	155.5
Revaluations	-	(20.3)	(20.3)
Currency translation differences	-	1.6	1.6
<b>At 31 March 2009</b>	-	136.8	136.8

The group's other investments mainly comprise a 15.0 per cent shareholding in Northern Gas Networks Holdings Limited. The group also holds an overall 11.7 per cent shareholding in Manila Water Company. In the opinion of the directors, there is no material difference between the book and fair values of these investments. The fair values of the group's financial instruments are shown in note 18.

During the prior year, the group accounted for its investment in THUS Group plc as an associate in accordance with IAS 28 'Investments in Associates' and applied equity accounting. The group's share of post-acquisition results for the period to disposal on 19 June 2007 (see note 8) has not been separately disclosed in the income statement or the statement of recognised income and expenditure on the grounds of materiality.

Details of principal operating subsidiary undertakings and joint ventures are set out below. These undertakings are included within the consolidated financial statements.

	Class of share capital held	Proportion share capital owed/voting rights %	Nature of business
<b>Subsidiary undertakings</b>			
<b>Great Britain</b>			
United Utilities Water PLC	Ordinary	100.0	Water and wastewater services services and network management
United Utilities Electricity Services Limited	Ordinary	100.0	Operation of electricity distribution network
United Utilities International Limited	Ordinary	100.0	Consulting services and project management
United Utilities Industrial Limited	Ordinary	100.0	Electricity asset maintenance
United Utilities Property Solutions Limited	Ordinary	100.0*	Property management
United Utilities Operational Services Limited	Ordinary	100.0	Operation and maintenance of water and wastewater assets of Dwr Cymru
United Utilities Operational Services (Highland) Limited	Ordinary	100.0	Operation and maintenance of wastewater assets
United Utilities Operational Services (Tay) Limited	Ordinary	100.0	Operation and maintenance of wastewater assets
United Utilities Operational Services (Moray) Limited	Ordinary	100.0	Operation and maintenance of wastewater assets
United Utilities Networks Limited	Ordinary	100.0	Multi-utility metering and network operations
United Utilities Operations Limited	Ordinary	100.0	Operation of gas distribution network

## Notes to the financial statements (continued)

### 13. Investments (continued)

	Class of share capital held	Proportion share capital owed/voting rights %	Nature of business
<b>Australia</b>			
United Utilities Australia Pty Limited	Ordinary	100.0	Water treatment operations, technical and management services
United Utilities Macarthur Operations Pty Limited	Ordinary	100.0	Technical and management services
Yabulu Water Pty Limited	Ordinary	100.0	Technical and management services
UU Victor Harbor Pty Limited	Ordinary	100.0	Wastewater treatment operations
UU Onkaparinga Pty Limited	Ordinary	100.0	Technical and management services
UU Berri Barmera Pty Limited	Ordinary	100.0	Water treatment operations
<b>Joint ventures</b>			
<b>Great Britain</b>			
Catchment Limited	Ordinary	50.0	Contract operations and maintenance services
Catchment (Tay) Limited	Ordinary	33.3	Contract operations and maintenance services
Catchment (Moray) Limited	Ordinary	33.3	Contract operations and maintenance services
Meter Fit (North West) Limited	Ordinary	50.0	Metering installation services
Meter Fit (North East) Limited	Ordinary	50.0	Metering installation services
UUGM Limited	Ordinary	60.0	Consulting services and project management
Scottish Water Solutions Limited	Ordinary	14.7	Consulting services and project management
4 Delivery Limited	Ordinary	40.0	Consulting services and project management
<b>Australia</b>			
Yan Yean Water Pty Limited	Ordinary	50.0	Water treatment operations
Macarthur Water Pty Limited	Ordinary	50.0	Water treatment operations
Riverland Water Pty Limited	Ordinary	50.0	Water treatment operations
Campaspe Asset Management Services Pty Limited	Ordinary	50.0	Asset management and water treatment
<b>Estonia</b>			
AS Tallinna Vesi	Ordinary	26.5	Contract operations and maintenance services
<b>Bulgaria</b>			
Sofiyska Voda AD	Ordinary	57.8	Contract operations and maintenance services
<b>Poland</b>			
Aqua Spolka Akcyjna	Ordinary	33.2	Contract operations and maintenance services
<b>Philippines</b>			
Water Capital Works Inc	Ordinary	27.0	Water treatment operations

\* Shares are held by subsidiary undertakings except where marked with an asterisk where shares are held directly by United Utilities PLC.

## Notes to the financial statements (continued)

### 13. Investments (continued)

A full list of the company's subsidiary undertakings is included within the company's annual return, to be filed with the Registrar of Companies.

In relation to the group's interests in joint ventures, the assets, liabilities, gross income and expenses are summarised below:

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Group share of joint ventures</b>		
Non-current assets	346.3	318.1
Current assets	96.0	97.1
Non-current liabilities	(236.5)	(221.8)
Current liabilities	(81.5)	(80.9)
	<u>124.3</u>	<u>112.5</u>
	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Group share of joint ventures</b>		
Gross income	209.5	211.5
Expenses	(196.5)	(198.6)
Taxation	(1.8)	(3.3)
<b>Profit for the year</b>	<u>11.2</u>	<u>9.6</u>

The joint ventures have no significant contingent liabilities to which the group is exposed and the group has contingent liabilities of £80.7 million in relation to its interests in the joint ventures (2008: £78.0 million).

	Associate	Shares in subsidiary undertakings	Total
	£m	£m	£m
<b>Company</b>			
At 1 April 2007	65.0	5,203.3	5,268.3
Additions	-	149.0	149.0
Disposals	(65.0)	-	(65.0)
At 31 March 2008	-	5,352.3	5,352.3
Additions <sup>(1)</sup>	-	6,129.0	6,129.0
<b>At 31 March 2009</b>	<u>-</u>	<u>11,481.3</u>	<u>11,481.3</u>

**Note:**

(1) Additions of £6,129.0 million relate to an investment in non-voting A shares in subsidiary undertakings, which are designated as compound financial instruments.

United Utilities PLC's subsidiary undertakings are exposed to credit, liquidity and market risks, the details of which are found in note 18. Movements or variations in these risk factors will cause changes in the value of the company's investments in the subsidiary entities, which in turn could require an impairment charge.

### 14. Inventories

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Group</b>		
Raw materials and finished goods	11.3	10.8
Properties held for resale	51.9	41.3
Work in progress	9.8	11.2
	<u>73.0</u>	<u>63.3</u>

The company has no inventories (2008: £nil).

## Notes to the financial statements (continued)

### 15. Trade and other receivables

	<b>2009</b>	<b>Group</b>	<b>2009</b>	<b>Company</b>
	<b>£m</b>	2008	<b>£m</b>	2008
		£m		£m
Trade receivables	195.7	208.7	0.2	2.1
Amounts owed by subsidiary undertakings	-	-	1,739.1	1,286.3
Amounts owed by ultimate parent undertaking (see note 27)	1,482.3	-	-	-
Amounts owed by related parties (see note 27)	12.8	15.0	-	-
Other debtors	57.8	38.8	14.0	-
Prepayments and accrued income	247.1	221.9	6.8	11.5
	<u>1,995.7</u>	<u>484.4</u>	<u>1,760.1</u>	<u>1,299.9</u>

Trade and other receivables have been analysed between non-current and current as follows:

	<b>2009</b>	<b>Group</b>	<b>2009</b>	<b>Company</b>
	<b>£m</b>	2008	<b>£m</b>	2008
		£m		£m
Non-current	21.5	28.2	-	-
Current	1,974.2	456.2	1,760.1	1,299.9
	<u>1,995.7</u>	<u>484.4</u>	<u>1,760.1</u>	<u>1,299.9</u>

Trade receivables do not carry interest and are stated net of allowances for doubtful receivables, an analysis of which is as follows:

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Group</b>		
At 1 April	171.7	147.7
Amounts charged to operating expenses (see note 4)	53.6	56.0
Trade receivables written-off	(32.5)	(31.8)
Disposed of during the year	-	(0.2)
<b>At 31 March</b>	<u>192.8</u>	<u>171.7</u>

At each balance sheet date, the company and each of its subsidiaries evaluate the recoverability of trade receivables and record provisions for doubtful receivables based on experience.

An allowance for doubtful trade receivables of £1.3 million (2008: £nil) was held by the company at 31 March 2009. Amounts owed by subsidiary undertakings are shown net of an allowance for doubtful receivables of £80.0 million (2008: £10.1 million) relating to non-trading subsidiary undertakings. Any allowance for doubtful receivables is determined by a detailed review of balances due on a company by company basis and by reference to the ongoing activities of each company within the group.

## Notes to the financial statements (continued)

### 15. Trade and other receivables (continued)

#### Ageing of gross receivables

The following table provides information regarding the ageing of gross receivables:

<b>Group</b>	<b>Aged less than one year £m</b>	<b>Aged between one year and two years £m</b>	<b>Aged greater than two years £m</b>	<b>Carrying value £m</b>
<b>At 31 March 2009</b>				
Trade receivables - gross	199.1	65.2	124.2	388.5
Amounts owed by ultimate parent undertaking	1,482.3	-	-	1,482.3
Amounts owed by related parties	10.7	0.7	1.4	12.8
Other debtors	37.8	-	20.0	57.8
Prepayments and accrued income	246.5	0.3	0.3	247.1
<hr/>				
<b>At 31 March 2008</b>				
Trade receivables - gross	196.6	61.7	122.1	380.4
Amounts owed by related parties	13.6	0.3	1.1	15.0
Other debtors	17.8	0.1	20.9	38.8
Prepayments and accrued income	217.7	-	4.2	221.9

The above analysis in respect of gross trade receivables reconciles to net trade receivables by deduction of the allowance for doubtful receivables of £192.8 million (2008: £171.7 million).

The group manages its regulated bad debt risk by providing against gross trade receivables. 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 receivables.

<b>Company</b>	<b>Aged less than one year £m</b>	<b>Aged between one year and two years £m</b>	<b>Aged greater than two years £m</b>	<b>Carrying value £m</b>
<b>At 31 March 2009</b>				
Trade receivables - gross	1.0	0.2	0.3	1.5
Amounts owed by subsidiary undertakings – gross	863.1	56.8	899.2	1,819.1
Other debtors	14.0	-	-	14.0
Prepayments and accrued income	6.2	0.5	0.1	6.8
<hr/>				
<b>At 31 March 2008</b>				
Trade receivables - gross	1.0	1.1	-	2.1
Amounts owed by subsidiary undertakings – gross	389.1	(103.6)	1,010.9	1,296.4
Prepayments and accrued income	11.5	-	-	11.5

Amounts owed by subsidiary undertakings is a sum of all subsidiary balances where the total of inter-company tax, debt, interest and trade balances is in a net receivable position.

The above analysis in respect of gross trade receivables reconciles to net trade receivables by the deduction of the allowance for doubtful receivables of £1.3 million (2008: £nil).

The above analysis in respect of gross amounts owed by subsidiary undertakings reconciles to net amounts due by deduction of the allowance for doubtful receivables of £80.0 million (2008: £10.1 million) relating to non-trading subsidiary undertakings.

## Notes to the financial statements (continued)

### 15. Trade and other receivables (continued)

Trade and other receivables is split as follows:

	<b>2009</b>	<b>Group</b>	<b>2009</b>	<b>Company</b>
	<b>£m</b>	2008	<b>£m</b>	2008
		£m		£m
Debtors in respect of unmetered water supplies	89.6	74.4	-	-
Debtors in respect of metered water supplies	107.8	100.5	-	-
Sundry debtors	60.6	47.2	-	-
	<u>258.0</u>	<u>222.1</u>	<u>-</u>	<u>-</u>
Total regulated debtors				
Non-regulated debtors	1,737.7	262.3	1,760.1	1,299.9
	<u>1,995.7</u>	<u>484.4</u>	<u>1,760.1</u>	<u>1,299.9</u>
<b>Trade and other receivables</b>	<u><u>1,995.7</u></u>	<u><u>484.4</u></u>	<u><u>1,760.1</u></u>	<u><u>1,299.9</u></u>

The directors consider that the carrying amount of trade and other receivables approximates to their fair value, at both 31 March 2009 and 31 March 2008.

The group's average credit period taken on sales is 31 days (2008: 33 days).

### 16. Cash and cash equivalents

	<b>2009</b>	<b>Group</b>	<b>2009</b>	<b>Company</b>
	<b>£m</b>	2008	<b>£m</b>	2008
		£m		£m
Cash at bank and in hand	117.8	140.9	-	86.4
Short-term bank deposits	180.8	1,669.6	100.8	577.4
	<u>298.6</u>	<u>1,810.5</u>	<u>100.8</u>	<u>663.8</u>
<b>Cash and short-term deposits</b>	<u>298.6</u>	<u>1,810.5</u>	<u>100.8</u>	<u>663.8</u>
Bank overdrafts (included in borrowings, see note 17)	(86.8)	(105.3)	(1.6)	-
	<u>211.8</u>	<u>1,705.2</u>	<u>99.2</u>	<u>663.8</u>
<b>Cash and cash equivalents in the cashflow statement</b>	<u><u>211.8</u></u>	<u><u>1,705.2</u></u>	<u><u>99.2</u></u>	<u><u>663.8</u></u>

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

## Notes to the financial statements (continued)

### 17. Borrowings

The following analysis provides information about the contractual terms of the group's borrowings:

	2009 £m	2008 £m
<b>Group</b>		
<b>Non-current liabilities</b>		
Bonds	4,005.7	3,031.5
Bank and other term borrowings	1,194.4	701.1
Finance lease obligations	-	56.3
	5,200.1	3,788.9
<b>Current liabilities</b>		
Bonds	160.2	738.0
Euro-commercial paper	56.2	-
Bank and other term borrowings	156.6	22.4
Bank overdrafts	86.8	105.3
Finance lease obligations	-	12.7
Amounts due to ultimate parent undertaking	65.1	-
	524.9	878.4
	5,725.0	4,667.3

### Terms and debt repayment schedule

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

			2009 Fair value £m	2009 Carrying value £m	2008 Fair value £m	2008 Carrying value £m
<b>Group</b>	Currency	Year of maturity				
<b>Borrowings in fair value hedge relationships</b>						
5.625% 300m bond	GBP	2027	286.1	338.3	281.0	301.1
5.75% 275m bond	GBP	2022	274.7	270.3	-	-
5.25% 150m bond	GBP	2010	154.1	153.2	150.5	148.5
5.375% 150m bond	GBP	2018	158.8	164.4	149.0	147.4
5% 200m bond	GBP	2035	165.1	220.3	171.4	191.6
4.875% 600m bond	EUR	2009	-	-	479.0	473.2
4.25% 500m bond	EUR	2020	425.0	479.7	345.7	373.4
4.55% 250m bond	USD	2018	150.2	191.5	114.1	124.6
5.375% 350m bond	USD	2019	218.0	285.1	169.3	186.0
6.45% 500m bond	USD	2008	-	-	259.9	251.8
5.02% JPY 10bn dual currency loan	JPY/USD	2029	76.7	94.5	56.6	62.2
<b>Borrowings designated at fair value through profit or loss</b>						
6.875% 400m bond	USD	2028	259.7	259.7	208.7	208.7
1.135% 3bn bond	JPY	2013	20.0	20.0	14.4	14.4

## Notes to the financial statements (continued)

### 17. Borrowings (continued)

			2009		2008	
	Currency	Year of maturity	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m
<b>Borrowings measured at amortised cost</b>						
1.5802%+RPI 100m 1L bond	GBP	2042	68.3	112.6	88.9	107.2
1.7829%+RPI 100m 1L bond	GBP	2040	74.4	113.0	95.3	107.6
1.9799%+RPI 100m 1L bond	GBP	2035	83.2	114.2	102.3	108.7
3.375%+RPI 50m 1L bond	GBP	2032	60.0	60.6	71.3	57.6
1.3258%+RPI 50m 1L bond	GBP	2041	32.1	56.4	41.7	53.7
1.397%+RPI 50m 1L bond	GBP	2046	30.4	56.3	41.4	53.6
1.3805%+RPI 35m 1L bond	GBP	2056	19.6	36.8	24.6	36.8
1.435%+RPI 50m 1L bond	GBP	2056	28.6	52.6	35.9	52.5
1.556%+RPI 50m 1L bond	GBP	2056	30.2	52.8	37.7	52.7
1.5865%+RPI 50m 1L bond	GBP	2056	30.3	53.1	37.9	53.0
1.591%+RPI 25m 1L bond	GBP	2056	15.1	26.5	18.9	26.4
1.662%+RPI 100m 1L bond	GBP	2056	62.7	106.2	78.0	106.0
1.815%+RPI 100m 1L bond	GBP	2056	66.5	106.4	82.4	106.2
1.847%+RPI 100m 1L bond	GBP	2056	67.5	106.8	83.4	106.7
1.5366%+RPI 50m 1L bond	GBP	2043	33.8	56.2	44.1	53.5
1.7937%+RPI 50m 1L bond	GBP	2049	37.1	56.1	46.4	53.4
1.585%+RPI 100m 1L bond	GBP	2057	60.5	102.2	75.7	102.0
1.702%+RPI 50m 1L bond	GBP	2057	31.7	51.5	39.6	51.4
1.66%+RPI 35m 1L bond	GBP	2037	24.3	35.4	30.1	35.4
1.97%+RPI 200m 1L loan	GBP	2016	183.7	220.2	194.1	209.0
1.61%+RPI 50m IL loan	GBP	2020	42.3	48.5	-	-
1.73%+RPI 50m IL loan	GBP	2020	42.9	48.4	-	-
1.84%+RPI 50m IL loan	GBP	2020	43.7	48.4	-	-
1.88%+RPI 50m IL loan	GBP	2020	43.5	48.2	-	-
1.90%+RPI 50m IL loan	GBP	2020	43.7	48.3	-	-
1.93%+RPI 50m IL loan	GBP	2020	43.8	48.2	-	-
2.10%+RPI 50m IL loan	GBP	2020	44.6	48.1	-	-
2.46%+RPI 50m IL loan	GBP	2020	46.4	48.2	-	-
6.125% 375m bond	GBP	2015	405.9	379.1	-	-
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	6.5	6.3	6.5	6.4
4.21% 10m bond	EUR	2008	-	-	8.0	8.0
0.385%+LIBOR (floating) 10m bond	USD	2008	-	-	5.0	5.0
0.365%+LIBOR (floating) 10m bond	USD	2009	7.0	7.0	5.1	5.0
1.3%+LIBOR (floating) 5bn bond	JPY	2017	38.8	35.3	-	-
Long-term bank borrowings - fixed	GBP	2008	-	-	5.1	5.0
Long-term bank borrowings - floating	GBP	2010-12	250.3	250.0	200.0	200.0
Commission for New Towns loan	GBP	2053	45.1	30.8	48.6	31.0
Other debt issued by joint ventures	Various	Various	230.1	230.1	216.3	216.3
Euro-commercial paper	Various	2009	56.2	56.2	-	-
Committed facilities - drawn	GBP	2009	55.0	55.0	-	-
Short-term bank borrowings - fixed	GBP	2009	84.1	84.1	-	-
<b>Other borrowings</b>						
Finance lease obligations	GBP	2014	-	-	69.0	69.0
Bank overdrafts	GBP	2009	86.8	86.8	105.3	105.3
Amounts due to ultimate parent undertaking	GBP	2009	65.1	65.1	-	-
			<u>4,910.2</u>	<u>5,725.0</u>	<u>4,338.2</u>	<u>4,667.3</u>

Abbreviations used in the above table are defined on page 71.

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)

### 17. Borrowings (continued)

#### Finance lease obligations

Finance lease obligations are payable as follows:

Group	Minimum lease payments		Present value of minimum lease payments	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts payable under finance leases:				
Within one year	-	12.7	-	12.7
In the second to fifth years inclusive	-	55.7	-	45.6
After five years	-	16.0	-	10.7
	-	84.4	-	69.0
Less future finance charges	-	(15.4)	-	-
Present value of lease obligations	-	69.0	-	69.0
Less amount due for settlement within 12 months			-	(12.7)
<b>Amount due for settlement after 12 months</b>			-	<b>56.3</b>

On 31 March 2009, the group closed out a finance lease which had a maturity date of 2014. The carrying value of the lease on 31 March 2009 was £60.9 million.

Interest rates implicit in the minimum lease payments were fixed on completion of the infrastructure build when the primary period of the lease commenced. In addition, contingent rentals were either payable or receivable, which adjusted the minimum lease payments to reflect changes in future market rates of interest. These contingent rentals were recognised as an increase or reduction in the finance expense in the period to which they related. Contingent rentals recognised as a reduction in finance expense in the year totalled £2.3 million (2008: £2.6 million).

The net finance charge for the year, after adjusting for contingent rentals, was £2.7 million (2008: £3.2 million) (see note 6) and the effective borrowing rate (after adjusting for contingent rentals) for the year was 3.928 per cent (2008: 5.048 per cent). The average lease term was six years as at 31 March 2008.

The group's obligations under finance leases were unsecured at 31 March 2008. The directors considered the fair value of the group's lease obligations approximate to their carrying value at 31 March 2008.

The company has no finance lease obligations.

#### Company

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

Company	2009 £m	2008 £m
<b>Non-current liabilities</b>		
Bonds	759.2	521.0
Bank and other term borrowings	-	0.3
	<u>759.2</u>	<u>521.3</u>
<b>Current liabilities</b>		
Bonds	7.0	264.8
Bank and other term borrowings	99.1	-
Bank overdraft	1.6	-
Euro-commercial paper	18.5	-
Amounts owed to subsidiary undertakings	698.8	591.2
Amounts owed to ultimate parent company	65.1	-
	<u>890.1</u>	<u>856.0</u>
	<u>1,649.3</u>	<u>1,377.3</u>

## Notes to the financial statements (continued)

### 17. Borrowings (continued)

#### Terms and debt repayment schedule

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

Company	Currency	Year of maturity	2009		2008	
			Fair value £m	Carrying value £m	Fair value £m	Carrying value £m
<b>Borrowings in fair value hedge relationships</b>						
4.55% 250m bond	USD	2018	150.2	191.5	114.1	124.6
5.375% 350m bond	USD	2019	218.0	285.1	169.3	186.0
6.45% 500m bond	USD	2008	-	-	259.9	251.8
<b>Borrowings measured at amortised cost</b>						
6.875% 400m bond	USD	2028	259.7	276.3	208.7	199.0
4.21% 10m bond	EUR	2008	-	-	8.0	8.0
0.24%+LIBOR (floating) 6.5m bond	GBP	2013	6.5	6.3	6.5	6.4
0.385%+LIBOR (floating) 10m bond	USD	2008	-	-	5.0	5.0
0.365%+LIBOR (floating) 10m bond	USD	2009	7.0	7.0	5.1	5.0
Long-term bank borrowings - floating	GBP	2010	-	-	0.3	0.3
Euro-commercial paper	Various	2009	18.5	18.5	-	-
Committed facilities – drawn	GBP	2009	15.0	15.0	-	-
Short-term bank borrowings – fixed	GBP	2009	84.1	84.1	-	-
Amounts owed to subsidiary undertakings	GBP	n/a	698.8	698.8	591.2	591.2
Amounts owed to ultimate parent undertaking	GBP	n/a	65.1	65.1	-	-
<b>Other borrowings</b>						
Bank overdrafts	GBP	2009	1.6	1.6	-	-
			1,524.5	1,649.3	1,368.1	1,377.3

Borrowings are unsecured.

#### Notes:

##### Currency

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

##### Index-linked debt

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

### 18. Financial instruments

#### Risk management

All of the group'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 group'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 group modifies and enhances its risk management policies and systems to reflect changes in markets and products. The board formulates the high level group risk management policy. The 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 group. The group's treasury function, which is authorised

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Risk management (continued)

to conduct the day-to-day treasury activities of the group, reports annually to the board and quarterly to the treasury committee.

The group'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 group has policies and procedures to control and monitor credit risk. The group does not believe it is exposed to any material concentrations of credit risk.

The group 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. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. Due to this, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 15).

The counterparties in respect of treasury activities consist of financial institutions and other bodies considered to have good credit ratings. Although the group 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 does 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 maximum exposure to credit risk for the group and the company was as follows:

	Group		Company	
	2009	2008	2009	2008
	£m	£m	£m	£m
Cash and short-term deposits	298.6	1,810.5	100.8	663.8
Trade and other receivables	1,995.7	484.4	1,760.1	1,299.9
Investments	136.8	155.5	-	-
Derivative financial instruments	639.0	143.3	174.6	0.9
	<u>3,070.1</u>	<u>2,593.7</u>	<u>2,035.5</u>	<u>1,964.6</u>

Included within trade and other receivables are amounts owed by the ultimate parent undertaking of £1,482.3m (2008: £nil).

Cash and short-term deposits and trade and other receivables are measured at amortised cost. Investments and derivative financial instruments are measured at fair value.

The credit exposure on derivatives is disclosed gross of any collateral received from the respective counterparties. As at 31 March 2009 the group held £84.1 million (2008: £nil) as collateral in relation to swap contracts.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Liquidity risk

Liquidity risk is the risk that the group will not have sufficient funds to meet the obligations or commitments arising from its business operations and its financial liabilities. The group manages the liquidity profile of its assets, liabilities and commitments so that cashflows 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 to the board monthly using a headroom figure.

At 31 March the headroom was as follows:

	<b>2009</b>	2008
	<b>£m</b>	£m
<b>Group</b>		
Cash and short-term deposits	298.6	1,810.5
Medium-term committed undrawn bank facilities	1,075.8	1,549.6
Short-term debt	(307.2)	(105.3)
Term debt maturing within one year	(177.7)	(760.4)
	<u>889.5</u>	<u>2,494.4</u>

Short-term deposits mature within three months. Bank overdrafts are repayable on demand.

Short-term debt includes £84.1 million (2008: £nil) collateral liability pledged in relation to a particular swap contract.

Medium-term committed bank facilities excludes £335.0 million (2008: £50.0 million) of facilities expiring within one year.

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

	<b>Group</b>		<b>Company</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>£m</b>	£m	<b>£m</b>	£m
Expiring within one year	350.0	50.0	300.0	25.0
Expiring after one year but in less than two years	300.0	350.0	125.0	300.0
Expiring after more than two years	895.0	1,245.0	620.0	720.0
Total borrowing facilities	<u>1,545.0</u>	<u>1,645.0</u>	<u>1,045.0</u>	<u>1,045.0</u>
Facilities drawn <sup>(1)</sup>	(55.0)	-	(15.0)	-
Offsetting bank guarantees	(79.2)	(45.4)	(79.2)	(45.4)
<b>Undrawn borrowing facilities</b>	<u>1,410.8</u>	<u>1,599.6</u>	<u>950.8</u>	<u>999.6</u>

**Note:**

(1) £15.0 million (company: £15.0 million) of these were facilities expiring within one year (2008: £nil) and £40.0 million (company: £nil) were facilities expiring after more than two years (2008: £nil).

In addition to the committed facilities available, the group uses its €2 billion euro-commercial paper programme to help it manage its liquidity position.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Maturity analysis

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

	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Group</b>								
<b>At 31 March 2009</b>								
Bonds	10,221.6		323.1	158.7	159.6	167.0	183.8	9,229.4
Bank and other term borrowings	2,123.1		315.9	82.8	84.1	188.0	29.4	1,422.9
Amounts owed to ultimate parent undertaking	65.1		65.1	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(6,684.8)	(6,684.8)						
<b>Financial liabilities excluding derivatives</b>	<b>5,725.0</b>	<b>(6,684.8)</b>	<b>704.1</b>	<b>241.5</b>	<b>243.7</b>	<b>355.0</b>	<b>213.2</b>	<b>10,652.3</b>
Derivatives:								
Payable	1,016.6		237.6	115.8	95.5	97.0	65.4	405.3
Receivable	(1,653.5)		(395.6)	(130.5)	(113.5)	(137.8)	(191.8)	(684.3)
Adjustment to carrying value <sup>(2)</sup>	151.0	151.0						
<b>Derivatives – net assets</b>	<b>(485.9)</b>	<b>151.0</b>	<b>(158.0)</b>	<b>(14.7)</b>	<b>(18.0)</b>	<b>(40.8)</b>	<b>(126.4)</b>	<b>(279.0)</b>
<b>Group</b>								
<b>At 31 March 2008</b>								
Bonds	9,654.6		892.7	270.4	103.4	108.1	117.4	8,162.6
Bank and other term borrowings	1,357.4		148.3	37.3	37.8	87.4	181.4	865.2
Finance lease obligations	84.4		12.7	13.0	13.6	14.2	14.9	16.0
Adjustment to carrying value <sup>(2)</sup>	(6,429.1)	(6,429.1)						
<b>Financial liabilities excluding derivatives</b>	<b>4,667.3</b>	<b>(6,429.1)</b>	<b>1,053.7</b>	<b>320.7</b>	<b>154.8</b>	<b>209.7</b>	<b>313.7</b>	<b>9,043.8</b>
Derivatives:								
Payable	2,806.4		2,435.7	95.1	60.6	60.5	63.6	90.9
Receivable	(2,766.4)		(2,371.7)	(111.5)	(57.8)	(53.0)	(54.2)	(118.2)
Adjustment to carrying value <sup>(2)</sup>	6.6	6.6						
<b>Derivatives – net liabilities</b>	<b>46.6</b>	<b>6.6</b>	<b>64.0</b>	<b>(16.4)</b>	<b>2.8</b>	<b>7.5</b>	<b>9.4</b>	<b>(27.3)</b>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Maturity analysis (continued)

<b>Company</b>	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>At 31 March 2009</b>								
Bonds	1,367.1		47.5	40.4	40.6	47.2	40.4	1,151.0
Bank and other term borrowings	119.7		119.7	-	-	-	-	-
Amounts owed to ultimate parent undertaking	65.1		65.1	-	-	-	-	-
Amounts owed to subsidiary undertakings	698.8		698.8	-	-	-	-	-
Adjustment to carrying value <sup>(2)</sup>	(601.4)	(601.4)						
<b>Financial liabilities excluding derivatives</b>	<b>1,649.3</b>	<b>(601.4)</b>	<b>931.1</b>	<b>40.4</b>	<b>40.6</b>	<b>47.2</b>	<b>40.4</b>	<b>1,151.0</b>
Derivatives:								
Payable	328.8		50.6	7.3	10.1	12.4	11.1	237.3
Receivable	(531.4)		(58.7)	(21.1)	(21.1)	(21.2)	(94.0)	(315.3)
Adjustment to carrying value <sup>(2)</sup>	34.6	34.6						
<b>Derivatives – net assets</b>	<b>(168.0)</b>	<b>34.6</b>	<b>(8.1)</b>	<b>(13.8)</b>	<b>(11.0)</b>	<b>(8.8)</b>	<b>(82.9)</b>	<b>(78.0)</b>
<b>At 31 March 2008</b>								
Bonds	1,282.5		303.5	35.8	31.1	31.4	38.2	842.5
Bank and other term borrowings	0.3		-	-	0.3	-	-	-
Amounts owed to subsidiary undertakings	591.2		591.2	-	-	-	-	-
Adjustment to carrying value	(496.7)	(496.7)						
<b>Financial liabilities excluding derivatives</b>	<b>1,377.3</b>	<b>(496.7)</b>	<b>894.7</b>	<b>35.8</b>	<b>31.4</b>	<b>31.4</b>	<b>38.2</b>	<b>842.5</b>
Derivatives:								
Payable	363.1		356.2	6.9	-	-	-	-
Receivable	(280.4)		(274.0)	(6.4)	-	-	-	-
Adjustment to carrying value	(1.7)	(1.7)						
<b>Derivatives – net liabilities</b>	<b>81.0</b>	<b>(1.7)</b>	<b>82.2</b>	<b>0.5</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

#### Notes:

- (1) Forecast future cashflows are calculated, where applicable, utilising forward interest rates based upon the interest environment at year end and are, therefore, susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be 2.65 per cent over the life of each bond.
- (2) The carrying value of debt is calculated following various methods in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and, therefore, this adjustment reconciles the undiscounted forecast future cashflows to the carrying value of debt in the balance sheet.

## Notes to the financial statements (continued)

### 18. 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 group's results. The management of market risk is undertaken with risk limits approved by the board.

The group 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 group 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 group's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The group's floating rate borrowings are exposed to a risk of change in cashflows due to changes in interest rates. The group uses interest rate swap contracts and financial futures to hedge these exposures. Investments in equity securities and short-term receivables and payables are not exposed to interest rate risk.

The group's policy is to structure debt in a way that best matches the cashflows generated by its underlying assets. Revenues from the regulated business are determined by the real cost of capital fixed by the regulator for each five-year regulatory pricing period. The preferred form of debt, therefore, is sterling index-linked debt which is fixed in real terms also. Where conventional long-term debt is raised in a fixed rate form, the group will swap to floating rate, at inception over the life of the liability, through the use of interest rate swaps.

The group, using a second layer of interest rate swaps, fixes in nominal terms a material proportion of the floating cost of debt for the duration of the five-year regulatory pricing period to match better the fixed nature of the group's revenue stream.

The group assesses any residual floating rate exposure with regard to net debt, after the effect of derivative contracts, to determine whether to hedge using futures contracts.

#### Sensitivity analysis

As required by IFRS 7 'Financial Instruments: Disclosures', the sensitivity analysis has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2009 and 31 March 2008, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year.

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

- all fair value hedge relationships, including associated swaps classified as held for trading, are fully effective and therefore there is no balance sheet sensitivity to interest rates with regard to these designated debt and swaps instruments;
- all borrowings designated at fair value through profit or 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 floating rate exposure to fixed rate for the five-year regulatory period;

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Sensitivity analysis (continued)

- 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 12-month impact on interest;
- the standard requires that a change in the relevant risk variable be applied to the risk exposures in existence at the balance sheet date, therefore 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 movements in interest rates. It is assumed that inflation is held constant;
- financial futures contracts entered into by the group to further manage the floating interest rate exposure are 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 has assessed 100bp as a reasonably possible movement in UK interest rates; and
- all other factors are held constant.

	<b>Group</b>		<b>Company</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>£m</b>	£m	<b>£m</b>	£m
<b>Impact on profit before taxation and equity</b>				
100bp increase in interest rate	64.4	35.4	(8.2)	(3.3)
100bp decrease in interest rate	(67.6)	(42.2)	8.6	2.6

Brackets denote a reduction in profit.

The exposure largely relates to the fair value exposure on the group's fixed rate financing. Management assesses the net interest exposure and determines whether to mitigate this risk further by entering into financial futures contracts. At 31 March 2009, the group had no financial futures contracts in place. At 31 March 2008, the group had financial futures contracts in place to materially fix its net floating interest rate exposure.

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Repricing analysis

The following tables categorise the group's borrowings, derivatives and cash deposits on the basis of when they reprice or, if earlier, mature. The repricing analysis demonstrates the group's exposure to floating rate risk prior to the effect of financial futures.

<b>Group</b>	<b>Total</b>	<b>1 year</b>	<b>1-2</b>	<b>2-3</b>	<b>3-4</b>	<b>4-5</b>	<b>More</b>
	<b>£m</b>	<b>or less</b>	<b>years</b>	<b>years</b>	<b>years</b>	<b>years</b>	<b>than 5</b>
<b>At 31 March 2009</b>		<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>years</b>
							<b>£m</b>
<b>Borrowings in hedge relationships:</b>							
Fixed rate instruments	2,197.3	153.2	-	-	-	-	2,044.1
Effect of swaps	-	2,044.1	-	-	-	-	(2,044.1)
	<u>2,197.3</u>	<u>2,197.3</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings designated at fair value through the profit or loss:</b>							
Fixed rate instruments	279.7	-	-	-	-	20.0	259.7
Effect of swaps	-	279.7	-	-	-	(20.0)	(259.7)
	<u>279.7</u>	<u>279.7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost:</b>							
Fixed rate instruments	695.4	195.7	0.8	0.6	2.7	0.9	494.7
Floating rate instruments	525.3	525.3	-	-	-	-	-
Index-linked instruments	1,962.2	1,962.2	-	-	-	-	-
	<u>3,182.9</u>	<u>2,683.2</u>	<u>0.8</u>	<u>0.6</u>	<u>2.7</u>	<u>0.9</u>	<u>494.7</u>
Effect of a fixed hedge for the term of the regulatory period	-	(1,475.5)	348.4	-	-	-	1,127.1
<b>Total external borrowings</b>	<u>5,659.9</u>	<u>3,684.7</u>	<u>349.2</u>	<u>0.6</u>	<u>2.7</u>	<u>0.9</u>	<u>1,621.8</u>
Amounts owed to ultimate parent undertaking	65.1	65.1	-	-	-	-	-
<b>Total borrowings</b>	<u>5,725.0</u>	<u>3,749.8</u>	<u>349.2</u>	<u>0.6</u>	<u>2.7</u>	<u>0.9</u>	<u>1,621.8</u>
Cash and short-term deposits	(298.6)	(298.6)	-	-	-	-	-
<b>Net borrowings</b>	<u>5,426.4</u>	<u>3,451.2</u>	<u>349.2</u>	<u>0.6</u>	<u>2.7</u>	<u>0.9</u>	<u>1,621.8</u>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Re-pricing analysis (continued)

<b>Group</b>	Total	1 year	1-2	2-3	3-4	4-5	More
At 31 March 2008	£m	or less	years	years	years	years	than 5
<b>Borrowings in hedge relationships:</b>	£m	£m	£m	£m	£m	£m	£m
Fixed rate instruments	2,259.8	725.0	148.5	-	-	-	1,386.3
Effect of swaps	-	1,534.8	(148.5)	-	-	-	(1,386.3)
	2,259.8	2,259.8	-	-	-	-	-
<b>Borrowings designated at fair value through profit or loss:</b>							
Fixed rate instruments	223.1	-	-	-	-	-	223.1
Effect of swaps	-	223.1	-	-	-	-	(223.1)
	223.1	223.1	-	-	-	-	-
<b>Borrowings measured at amortised cost:</b>							
Fixed rate instruments	108.2	13.8	0.2	0.2	0.8	3.7	89.5
Floating rate instruments	542.8	542.8	-	-	-	-	-
Index-linked instruments	1,533.4	1,533.4	-	-	-	-	-
	2,184.4	2,090.0	0.2	0.2	0.8	3.7	89.5
Effect of a fixed hedge for the term of the regulatory period	-	(2,030.6)	1,582.2	448.4	-	-	-
<b>Total borrowings</b>	4,667.3	2,542.3	1,582.4	448.6	0.8	3.7	89.5
Cash and short-term deposits	(1,810.5)	(1,810.5)	-	-	-	-	-
<b>Net borrowings</b>	2,856.8	731.8	1,582.4	448.6	0.8	3.7	89.5

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Re-pricing analysis (continued)

Company	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>At 31 March 2009</b>							
<b>Borrowings in hedge relationships:</b>							
Fixed rate instruments	476.6	-	-	-	-	-	476.6
Effect of swaps	-	476.6	-	-	-	-	(476.6)
	476.6	476.6	-	-	-	-	-
<b>Borrowings measured at amortised cost:</b>							
Fixed rate instruments	393.9	117.6	-	-	-	-	276.3
Floating rate instruments	14.9	14.9	-	-	-	-	-
	408.8	132.5	-	-	-	-	276.3
Effect of a fixed hedge for the term of the regulatory period	-	-	-	-	-	-	-
<b>Total external borrowings</b>	885.4	609.1	-	-	-	-	276.3
Amounts owed to subsidiary undertakings measured at amortised cost	698.8	698.8	-	-	-	-	-
Amounts owed to ultimate parent undertaking	65.1	65.1	-	-	-	-	-
<b>Total borrowings</b>	1,649.3	1,373.0	-	-	-	-	276.3
Cash and short-term deposits	(100.8)	(100.8)	-	-	-	-	-
<b>Net borrowings</b>	1,548.5	1,272.2	-	-	-	-	276.3

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Re-pricing analysis (continued)

Company	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
At 31 March 2008							
<b>Borrowings in hedge relationships:</b>							
Fixed rate instruments	562.4	251.8	-	-	-	-	310.6
Effect of swaps	-	310.6	-	-	-	-	(310.6)
	<u>562.4</u>	<u>562.4</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Borrowings measured at amortised cost:</b>							
Fixed rate instruments	207.0	8.0	-	-	-	-	199.0
Floating rate instruments	16.7	16.7	-	-	-	-	-
	<u>223.7</u>	<u>24.7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>199.0</u>
Effect of a fixed hedge for the term of the regulatory period	-	(190.0)	190.0	-	-	-	-
<b>Total external borrowings</b>	<u>786.1</u>	<u>397.1</u>	<u>190.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>199.0</u>
Amounts owed to subsidiary undertakings measured at amortised cost	591.2	591.2	-	-	-	-	-
<b>Total borrowings</b>	<u>1,377.3</u>	<u>988.3</u>	<u>190.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>199.0</u>
Cash and short-term deposits	(663.8)	(663.8)	-	-	-	-	-
<b>Net borrowings</b>	<u>713.5</u>	<u>324.5</u>	<u>190.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>199.0</u>

#### Currency risk

The group's assets are principally sterling denominated; however, the group 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 group's policy is generally to swap the foreign currency denominated cashflows into sterling through the use of foreign currency swaps. As a result, for the majority of foreign currency denominated borrowings, the group has no material exposure to movements in exchange rates.

Under a currency swap, the group 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 principal amount. The principal of these instruments reflects the extent of the group's involvement in the instruments but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

As required by IFRS 7, the foreign exchange rate risk sensitivity analysis has been prepared on the basis of the net debt positions in place as at 31 March 2009 and 31 March 2008, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following assumptions were made in calculating the sensitivity analysis:

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Currency risk (continued)

- management has assessed 10 per cent to be a reasonably possible movement across all foreign exchange rates;
- as required by IFRS 7, the impact has been assessed for monetary items only;
- the sensitivity to JPY is the result of forward exchange contracts denominated in JPY. In calculating the sensitivity in movements in the GBP/JPY exchange rate, it has been assumed that the theoretical relationship between forward exchange rates, spot exchange rates and the interest rate differential between the two currencies holds true; and
- all other factors are held constant.

<b>Group</b>	<b>2009</b>	2008
	<b>JPY</b>	JPY
	<b>£m</b>	£m
<b>Impact on profit before taxation</b>		
10 per cent increase in exchange rates	-	(2.3)
10 per cent decrease in exchange rates	-	2.6
	<hr/>	<hr/>

Brackets denote a reduction in profit.

During the year, the group closed out its JPY foreign investment and related forward contracts resulting in no exposure as at 31 March 2009.

For JPY, the impact on equity is £nil increase for a 10 per cent increase in exchange rates (2008: increase £135.5 million) and £nil decrease for a 10 per cent decrease in exchange rates (2008: decrease £165.9 million).

The difference between the impact on equity and the impact on profit before taxation was due to the equity impact including movements in JPY denominated forward contracts which were used as hedging instruments in hedges of net investments in foreign operations, but excluding the impact of the retranslation of the investments which the forwards were hedging – due to the investments not being financial assets as defined by IFRS 7. Had the impact of the retranslation of the investments been included in the above analysis, the impact on profit before taxation and impact on equity would have been equal. Sensitivity analyses for United States dollar and euro have not been presented as, due to the swaps in place to hedge the risk, the group has no material exposure to these currencies.

The company has no material exposure to currency risk.

#### Inflation risk

The group's index-linked borrowings and interest liabilities are exposed to a risk of change in carrying value due to changes in the UK RPI. This form of liability is a good match for the group'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 liabilities to assets, index-linked debt hedges the exposure to changes in RPI and delivers a cashflow 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. As such, the ability to issue this form of debt is limited.

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

	<b>2009</b>	2008
	<b>£m</b>	£m
Index linked debt	1,962.2	1,533.4
	<hr/>	<hr/>

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Inflation risk (continued)

As required by IFRS 7, the sensitivity analysis has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2009 and 31 March 2008, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI, excluding the hedging aspect of the group's regulatory assets, which are not financial assets as defined by IAS 32 'Financial Instruments: Disclosure and Presentation':

<b>Group</b>	<b>2009</b>	<b>2008</b>
	<b>£m</b>	<b>£m</b>
<b>Impact on profit before taxation and equity</b>		
One per cent increase in RPI	(20.0)	(15.7)
One per cent decrease in RPI	20.0	15.7

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 12-month period. It should be noted, however, that there is a time lag by which current RPI changes impact on the profit and loss and the analysis above does not incorporate this factor. The portfolio of index-linked debt is either calculated on a three or eight-month lag basis. Therefore, at the balance sheet date the index-linked interest and principal adjustments impacting the income statement are fixed and based upon either the previous three or eight-month RPI.

The company has no material exposure to inflation risk.

#### Capital risk management

The group's objective when managing capital is to maintain a capital structure that enables its primary subsidiary, United Utilities Water PLC, to retain a credit rating of A3, which the group 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 group's ability to earn a reasonable return on its capital, securing access to finance at a reasonable cost and enabling the group 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 group needs 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 upon 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 group's strategy of targeting a credit rating of A3 for United Utilities Water PLC was announced as part of the 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, United Utilities Group PLC returned £1.5 billion to shareholders (with a corresponding reduction in its equity base) during August 2008 and reduced dividend per share by 30 per cent with effect from February 2009.

## Notes to the financial statements (continued)

### 18. 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:

Group	2009 Carrying value £m	2009 Fair value £m	2008 Carrying value £m	2008 Fair value £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Available for sale investments	136.8	136.8	155.5	155.5
Loans and receivables:				
Trade and other receivables	21.5	21.5	28.2	28.2
Derivative financial instruments:				
Fair value hedge derivatives	412.6	412.6	44.3	44.3
<i>Current assets</i>				
Loans and receivables:				
Trade and other receivables	1,974.0	1,974.0	456.2	456.2
Cash and short-term deposits	298.6	298.7	1,810.5	1,814.1
Derivative financial instruments:				
Held for trading derivatives – swaps <sup>(3)</sup>	226.4	226.4	99.0	99.0
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Trade and other payables at amortised cost	(139.8)	(139.8)	(125.5)	(125.5)
Borrowings:				
Financial liabilities designated at fair value through profit or loss	(279.7)	(279.7)	(223.1)	(223.1)
Financial liabilities in hedged relationships:				
Fair value hedge	(2,044.1)	(1,754.6)	(1,534.8)	(1,437.6)
Other financial liabilities	(2,876.3)	(2,350.1)	(2,031.0)	(1,785.0)
	(5,200.1)	(4,384.4)	(3,788.9)	(3,445.7)
Derivative financial instruments:				
Fair value hedge derivatives - swaps	(4.5)	(4.5)	(53.2)	(53.2)
<i>Current liabilities</i>				
Trade and other payables at amortised cost	(673.7)	(673.7)	(771.9)	(771.9)
Borrowings:				
Financial liabilities in hedge relationships:				
Fair value hedge	(153.2)	(154.1)	(725.0)	(738.9)
Other financial liabilities	(371.7)	(371.7)	(153.4)	(153.6)
	(524.9)	(525.8)	(878.4)	(892.5)
Derivative financial instruments:				
Held for trading derivatives – swaps <sup>(3)</sup>	(148.6)	(148.6)	(136.7)	(136.7)
Adjustment for accrued interest <sup>(1)(2)</sup>	-	41.5	-	34.7
	(3,621.7)	(2,765.3)	(3,160.9)	(2,793.5)

#### Notes:

- (1) The fair values quoted include £nil interest receivable (2008: £2.8 million). This interest receivable is also included within the fair value of trade and other receivables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.
- (2) Fair values quoted include accrued interest of £41.5 million (2008: £37.5 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.
- (3) Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £182.8 million (2008: £59.5 million).

## Notes to the financial statements (continued)

### 18. Financial instruments (continued)

#### Fair values (continued)

In order to determine the fair values in the table above, all borrowings and derivatives are valued using a discounted cashflow valuation model as described within the accounting policies on pages 38-40. 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 for continuing operations of £56.6 million loss (2008: £5.7 million gain), £76.6 million gain (2008: £28.2 million gain) is attributable to changes in credit risk. The cumulative impact of changes in credit spread was £107.2 million profit (2008: £30.6 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £55.5 million (2008: a carrying amount decrease of £41.5 million).

Company	2009 Carrying value £m	2009 Fair value £m	2008 Carrying value £m	2008 Fair value £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Derivative financial instruments:				
Fair value hedge derivatives – swaps	172.8	172.8	-	-
<i>Current assets</i>				
Loans and receivables	1,760.1	1,760.1	1,299.9	1,299.9
Cash and short-term deposits	100.8	100.8	663.8	666.5
Derivative financial instruments:				
Held for trading derivatives - swaps	1.8	1.8	0.9	0.9
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Borrowings:				
Financial liabilities in hedged relationships:				
Fair value hedge	(476.6)	(368.2)	(310.6)	(283.4)
Other financial liabilities	(282.6)	(266.2)	(210.7)	(220.6)
	(759.2)	(634.4)	(521.3)	(504.0)
Derivative financial instruments:				
Fair value hedge derivatives - swaps	-	-	(30.1)	(30.1)
<i>Current liabilities</i>				
Trade and other payables at amortised cost	(6,276.6)	(6,276.6)	(615.6)	(615.6)
Borrowings:				
Fair value hedge	-	-	(251.8)	(259.9)
Other financial liabilities	(890.1)	(890.1)	(604.2)	(604.2)
	(890.1)	(890.1)	(856.0)	(864.1)
Derivative financial instruments:				
Held for trading derivatives - swaps	(6.6)	(6.6)	(51.8)	(51.8)
Adjustment for accrued interest <sup>(1)(2)</sup>	-	7.0	-	10.5
	(5,897.0)	(5,765.2)	(110.2)	(87.8)

#### Notes:

- (1) The fair value quoted includes £nil interest receivable (2008: £2.8 million). This interest receivable is also included within the fair value of trade and other receivables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.
- (2) Fair values quoted include accrued interest of £7.0 million (2008: £13.3 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations

The group participates in a number of pension schemes principally in the United Kingdom. The three major schemes are funded defined benefit schemes – the United Utilities Pension Scheme (UUPS), the United Utilities Group of the Electricity Supply Pension Scheme (ESPS) and the Northern Gas Networks Pension Scheme (NGNPS), all of which are closed to new employees. The assets of these schemes are held in trust funds independent of the group's finances.

The last actuarial valuation of UUPS was carried out as at 30 September 2008, ESPS was carried out as at 31 March 2008 and NGNPS was carried out as at 7 December 2005. These valuations have been updated to take account of the requirements of IAS 19 'Employee Benefits' in order to assess the position at 31 March 2009 by projecting forward from the dates of the respective valuations, and have been performed by an independent actuary, Mercer Limited.

On 31 March 2005, the group made lump-sum payments of £216.0 million and £103.5 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that were expected to have been payable for defined benefit members over the five years from 1 April 2005. The company made £16.7 million of contributions to the defined benefit schemes for the year ended 31 March 2009 (2008: £1.2 million). Whilst some company contributions to UUPS and ESPS resumed in respect of the defined benefit members during 2009, significant elements of the company contribution holiday following the lump sum payments continued during the year ended 31 March 2009. The group also continues to pay contributions in respect of NGNPS, 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 Group PLC. Overall, the group expects to contribute around £30.0 million of contributions to its defined benefit schemes in the year ending 31 March 2010.

The group made total contributions of £45.4 million (2008: £16.1 million) to its pension schemes for the year ended 31 March 2009. During the prior year, the group also contributed to the Essex County Council Pension Fund; following the disposal of the group's facilities management operations on 22 February 2008 no further contributions have been made. The group also operates a series of unfunded, unregistered retirement benefit schemes. The cost of the unfunded, unregistered retirement benefit schemes is included in the total pension cost, on a basis consistent with IAS 19 and the assumptions set out below. In accordance with these unfunded arrangements, the group made no lump sum payments to former directors in the year ended 31 March 2009 (2008: £0.9 million). The company made total contributions of £16.7 million (2008: £1.2 million) to its pension schemes for the year ended 31 March 2009.

The group's total defined benefit pension expense for the year was £33.0 million (2008: £52.2 million). A group pension obligation of £213.1 million is included in the balance sheet at 31 March 2009 (2008: £101.2 million). The company's total defined benefit pension expense for the year was £0.4 million (2008: £3.9 million income). A company pension obligation of £19.7 million is included in the balance sheet at 31 March 2009 (2008: £15.4 million). Information about the pension arrangements for executive directors is contained in note 3.

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

	<b>2009</b>	2008
	<b>%</b>	<b>%</b>
<b>Group and Company</b>		
Discount rate – UUPS	7.00	6.00
Discount rate – ESPS	7.00	6.10
Discount rate – NGNPS	6.90	5.80
Expected return on assets – UUPS	6.60	6.80
Expected return on assets – ESPS	6.20	6.50
Expected return on assets – NGNPS	5.90	6.20
Pensionable salary growth – UUPS	4.15	4.35
Pensionable salary growth – ESPS	4.20	4.40
Pensionable salary growth – NGNPS	4.20	4.40
Pension increases	3.20	3.40
Price inflation	3.20	3.40

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

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

	<b>2009</b>	2008
	<b>years</b>	years
<b>Group and Company</b>		
Retired member	24.9	24.9
Non-retired member	26.0	26.0

Studies in the last five years have shown faster rates of life expectancy improvement than had previously been expected. Studies have also illustrated that mortality rates vary significantly according to the demographics of the schemes' members. These factors have been taken into account in the calculation of the defined benefit obligations of the group.

At 31 March, the fair value of the schemes' assets and liabilities recognised in the balance sheet were as follows:

	<b>Schemes'</b>		Schemes'	
	<b>assets</b>	<b>2009</b>	assets	2008
	%	<b>£m</b>	%	£m
<b>Group</b>				
Equities	55.0	815.4	65.4	1,217.7
Gilts	10.2	152.1	19.4	360.6
Bonds	33.7	500.7	13.5	252.4
Property	0.7	9.8	0.7	13.2
Cash	0.4	5.8	1.0	19.3
Total fair value of schemes' assets	100.0	1,483.8	100.0	1,863.2
Present value of defined benefit obligations		(1,696.9)		(1,964.4)
<b>Net retirement benefit obligations</b>		<b>(213.1)</b>		<b>(101.2)</b>

	<b>Schemes'</b>		Schemes'	
	<b>assets</b>	<b>2009</b>	assets	2008
	%	<b>£m</b>	%	£m
<b>Company</b>				
Equities	55.5	157.4	62.6	216.7
Gilts	13.2	37.5	22.8	79.0
Bonds	30.9	87.5	13.8	47.6
Property	0.2	0.5	-	-
Cash	0.2	0.6	0.8	2.7
Total fair value of schemes' assets	100.0	283.5	100.0	346.0
Present value of defined benefit obligations		(303.2)		(361.4)
<b>Net retirement benefit obligations</b>		<b>(19.7)</b>		<b>(15.4)</b>

To develop the expected long-term rate of return on asset assumptions, the group considered the current level of expected returns on risk-free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based upon the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The group's actual return on schemes' assets was a loss of £372.1 million (2008: £74.2 million loss) and the company's actual return on the schemes' assets was a loss of £67.9 million (2008: £43.8 million loss).

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

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

	<b>Group</b>		<b>Company</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>£m</b>	£m	<b>£m</b>	£m
At 1 April	(1,964.4)	(2,835.3)	(361.4)	(388.8)
Interest cost on schemes' obligations	(117.5)	(137.0)	(21.6)	(20.1)
Actuarial gains	372.1	113.5	70.4	38.0
Curtailements/settlements	-	861.0	-	5.2
Member contributions	(9.2)	(11.0)	(0.4)	(0.3)
Benefits paid	61.9	100.4	11.7	14.5
Transfer on disposal of businesses	-	-	-	(6.9)
Current service cost	(36.7)	(46.0)	(1.9)	(1.8)
Past service cost	(3.1)	(10.0)	-	(1.2)
<b>At 31 March</b>	<b>(1,696.9)</b>	<b>(1,964.4)</b>	<b>(303.2)</b>	<b>(361.4)</b>

At 31 March 2009, £5.9 million (2008: £7.0 million) of the defined benefit obligations related to unfunded, unregistered benefit plans.

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

	<b>Group</b>		<b>Company</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>£m</b>	£m	<b>£m</b>	£m
At 1 April	1,863.2	2,896.6	346.0	398.9
Expected return on schemes' assets	124.3	165.7	23.1	24.8
Actuarial losses	(496.4)	(239.9)	(91.0)	(68.6)
Curtailements/settlements	-	(885.9)	-	(3.0)
Member contributions	9.2	11.0	0.4	0.3
Benefits paid	(61.9)	(100.4)	(11.7)	(14.5)
Transfer on disposal of businesses	-	-	-	6.9
Company contributions	45.4	16.1	16.7	1.2
<b>At 31 March</b>	<b>1,483.8</b>	<b>1,863.2</b>	<b>283.5</b>	<b>346.0</b>

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

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

	<b>Continuing operations 2009 £m</b>	Continuing operations 2008 £m	Discontinued operations 2008 £m	Total 2008 £m
<b>Group</b>				
Current service cost	(36.7)	(40.3)	(5.7)	(46.0)
Curtailments/settlements	-	5.6	-	5.6
Past service cost	(3.1)	(9.4)	(0.6)	(10.0)
<b>Pension expense charged to operating profit (see note 3)</b>	<b>(39.8)</b>	<b>(44.1)</b>	<b>(6.3)</b>	<b>(50.4)</b>
Expected return on schemes' assets	124.3	128.6	37.1	165.7
Interest on schemes' obligations	(117.5)	(105.1)	(31.9)	(137.0)
<b>Pension expense credited to investment income (see note 5)</b>	<b>6.8</b>	<b>23.5</b>	<b>5.2</b>	<b>28.7</b>
Curtailments/settlements charged to profit/(loss) on disposal	-	-	(30.5)	(30.5)
<b>Net pension charged before taxation</b>	<b>(33.0)</b>	<b>(20.6)</b>	<b>(31.6)</b>	<b>(52.2)</b>
			<b>2009 £m</b>	2008 £m
<b>Company</b>				
Current service cost			(1.9)	(1.8)
Curtailments/settlements			-	2.2
Past service cost			-	(1.2)
<b>Pension expense charged to operating profit (see note 3)</b>			<b>(1.9)</b>	<b>(0.8)</b>
Expected return on schemes' assets			23.1	24.8
Interest on schemes' obligations			(21.6)	(20.1)
<b>Pension expense credited to investment income</b>			<b>1.5</b>	<b>4.7</b>
<b>Net pension (charged)/credited before taxation</b>			<b>(0.4)</b>	<b>3.9</b>

The reconciliation of the opening and closing balance sheet position is as follows:

	<b>2009 £m</b>	<b>Group 2008 £m</b>	<b>2009 £m</b>	<b>Company 2008 £m</b>
At 1 April	(101.2)	61.3	(15.4)	10.1
Expenses recognised in the income statement	(33.0)	(52.2)	(0.4)	3.9
Contributions paid	45.4	16.1	16.7	1.2
Actuarial losses gross of taxation	(124.3)	(126.4)	(20.6)	(30.6)
<b>At 31 March</b>	<b>(213.1)</b>	<b>(101.2)</b>	<b>(19.7)</b>	<b>(15.4)</b>

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

Actuarial gains and losses are recognised directly in the statement of recognised income and expense. At 31 March 2009, a cumulative pre-tax loss of £95.1 million (2008: £29.2 million gain) for the group, and a cumulative loss of £68.2 million (2008: £47.6 million loss) for the company had been recorded directly in the statement of recognised income and expense.

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

	2009	2008	2007	2006	2005
	£m	£m	£m	£m	£m
<b>Group</b>					
Present value of defined benefit obligations	(1,696.9)	(1,964.4)	(2,835.3)	(2,721.0)	(2,382.3)
Fair value of schemes' assets	1,483.8	1,863.2	2,896.6	2,740.3	2,297.7
<b>Net retirement benefit (obligations)/surplus</b>	<b>(213.1)</b>	<b>(101.2)</b>	<b>61.3</b>	<b>19.3</b>	<b>(84.6)</b>
Experience adjustments on schemes' liabilities	(8.9)	23.8	92.6	-	(14.3)
Experience adjustments on schemes' assets	(496.4)	(239.9)	(43.3)	397.2	45.3
<b>Company</b>					
Present value of defined benefit obligations	(303.2)	(361.4)	(388.8)	(120.2)	(103.1)
Fair value of schemes' assets	283.5	346.0	398.9	119.0	94.9
<b>Net retirement benefit (obligations)/surplus</b>	<b>(19.7)</b>	<b>(15.4)</b>	<b>10.1</b>	<b>(1.2)</b>	<b>(8.2)</b>
Experience adjustments on schemes' liabilities	2.0	16.4	13.3	-	(0.6)
Experience adjustments on schemes' assets	(91.0)	(68.6)	(1.1)	16.4	1.9

At 31 March 2009, gross pension liabilities in respect of retirement benefit obligations for NGNPS were £171.7 million (2008: £200.6 million). Gross pension assets in respect of NGNPS at 31 March 2009 were £169.7 million (2008: £193.7 million). The group recorded a related deferred tax asset at 31 March 2009 of £0.6 million (2008: £1.9 million). The directors consider that the group should apply defined benefit accounting in respect of the scheme. However, the group does not have the responsibility to fund the net pension deficit and has reflected this by the recognition of an available for sale financial asset within investments of £1.4 million at 31 March 2009 (2008: £5.0 million).

#### Defined contribution pension costs

UUPS also includes a defined contribution section which constitutes around 1.0 per cent of the total asset value.

During the year, the group made £7.0 million (2008: £4.0 million) of contributions to defined contribution schemes, which are included in arriving at operating profit from continuing operations and a further £nil (2008: £0.7 million) which are recognised within discontinued operations. The company made £2.2 million (2008: £1.0 million) of contributions to defined contribution schemes.

## Notes to the financial statements (continued)

### 19. Retirement benefit obligations (continued)

#### Defined contribution pension costs (continued)

Various companies in the United Kingdom electricity business participate in the Electricity Supply Pension Scheme (ESPS), which is an industry-wide defined benefit scheme. The United Utilities Electricity Services Limited (UUES) section of the Electricity North West Limited (ENW) Group of the scheme was created in December 2007 to accommodate the transfer of employees from ENW (formerly United Utilities Electricity Limited) to UUES. At that date, the UUES section of the scheme was fully funded. The group makes cash contributions over the period of the Asset Services Agreement (ASA) between UUES and ENW, which are fully recoverable from ENW under the terms of the ASA. There is no obligation brought forward, or carried forward, for which the group is responsible. However, as the group is the employer, it is required to disclose the gross pension liabilities and assets associated with the scheme.

At 31 March 2009, gross pension liabilities in respect of retirement benefit obligations for the UUES section were £157.3 million (2008: £196.3 million). Gross pension assets in respect of the UUES section, at 31 March 2009, were £149.4 million (2008: £186.6 million). £13.6 million of cash contributions have been made to the UUES section of the ESPS during the year ended 31 March 2009 (19 December 2007 to 31 March 2008: £nil), these costs being charged to operating profit as defined contribution pension costs. Therefore, in total for continuing operations, the group incurred defined contribution pension costs of £20.6 million (2008: £4.0 million) (see note 3).

### 20. Deferred tax

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

				<b>Group</b>	<b>Company</b>
	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m	Total £m
At 1 April 2007	1,579.9	(92.4)	63.0	1,550.5	(7.3)
Change in taxation rate	(105.3)	6.1	(4.2)	(103.4)	0.5
Charged/(credited) to the income statement	51.4	84.6	(73.1)	62.9	10.6
Credited to equity	-	(35.4)	(0.4)	(35.8)	(8.6)
Disposed of during the year	(312.2)	8.8	(6.8)	(310.2)	-
<b>At 31 March 2008</b>	<b>1,213.8</b>	<b>(28.3)</b>	<b>(21.5)</b>	<b>1,164.0</b>	<b>(4.8)</b>
Abolition of industrial buildings allowances (see note 7)	206.4	-	-	206.4	-
Charged/(credited) to the income statement	35.4	3.4	(35.1)	3.7	2.7
Credited to equity	-	(34.8)	(0.4)	(35.2)	(5.8)
<b>At 31 March 2009</b>	<b>1,455.6</b>	<b>(59.7)</b>	<b>(57.0)</b>	<b>1,338.9</b>	<b>(7.9)</b>

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

## Notes to the financial statements (continued)

### 21. Provisions

	Restructuring £m	Onerous leases £m	Other £m	Group Total £m	Company Other and total £m
At 1 April 2007	6.3	7.7	24.9	38.9	14.5
Charged/(credited) to the income statement	22.3	(4.0)	4.9	23.2	(1.0)
Utilised in the year	(12.2)	-	(2.4)	(14.6)	(0.6)
Disposed of in the year	(4.1)	(3.7)	-	(7.8)	-
At 31 March 2008	12.3	-	27.4	39.7	12.9
Reclassified in the year	-	-	-	-	(8.5)
Charged/(credited) to the income statement	7.2	-	5.5	12.7	(0.5)
Utilised in the year	(8.1)	-	(4.5)	(12.6)	(1.4)
<b>At 31 March 2009</b>	<b>11.4</b>	<b>-</b>	<b>28.4</b>	<b>39.8</b>	<b>2.5</b>

The restructuring provision principally relates to severance and programme costs as a result of group reorganisation.

Other provisions principally relate to legal claims against the group and represent management's best estimate of the value of settlement and costs. It is estimated that these claims will be settled in more than one year.

Provisions have been analysed between current and non-current as follows:

	Restructuring £m	Other £m	Group Total £m	Company Other and total £m
<b>At 31 March 2009</b>				
Non-current	-	17.2	17.2	-
Current	11.4	11.2	22.6	2.5
	11.4	28.4	39.8	2.5
At 31 March 2008				
Non-current	-	18.7	18.7	8.5
Current	12.3	8.7	21.0	4.4
	12.3	27.4	39.7	12.9

## Notes to the financial statements (continued)

### 22. Trade and other payables

	<b>2009</b>	<b>Group</b>
	<b>£m</b>	<b>2008</b>
		<b>£m</b>
<b>Non-current</b>		
Deferred grants and contributions	136.0	122.1
Other creditors	3.8	3.4
	<u>139.8</u>	<u>125.5</u>

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

	<b>2009</b>	<b>Group</b>	<b>2009</b>	<b>Company</b>
	<b>£m</b>	<b>2008</b>	<b>£m</b>	<b>2008</b>
		<b>£m</b>		<b>£m</b>
<b>Current</b>				
Trade payables	86.6	78.8	1.1	2.0
Amounts owed to ultimate parent undertaking	1.3	-	0.6	-
Amounts owed to subsidiary undertakings	-	-	6,242.5	583.1
Amounts owed to related parties (see note 27)	1.9	0.1	-	-
Other tax and social security	7.7	7.1	0.9	0.6
Deferred grants and contributions	6.3	-	-	-
Other creditors	3.1	3.7	3.1	3.7
Accruals and deferred income	566.8	682.2	28.4	26.2
	<u>673.7</u>	<u>771.9</u>	<u>6,276.6</u>	<u>615.6</u>

The average credit period taken for trade purchases is 34 days for the group (2008: 29 days) and is 9 days (2008: 18 days) for the company.

The directors consider that the carrying amount of trade payables approximates to their fair value at both 31 March 2009 and 31 March 2008.

#### Deferred grants and contributions

	<b>2009</b>	<b>2008</b>
	<b>£m</b>	<b>£m</b>
<b>Group</b>		
At 1 April	122.1	400.1
Received in the year	26.6	69.3
Disposed of in the year	-	(334.7)
Credited to the income statement (see note 4)	(6.4)	(12.6)
<b>At 31 March</b>	<u>142.3</u>	<u>122.1</u>

Deferred grants are those amounts received under government grant schemes. Deferred contributions are those amounts received from customers in respect of new connections to the network.

## Notes to the financial statements (continued)

### 23. Shareholder's equity

	Share capital £m	Share premium account £m	Revaluation reserve £m	Treasury shares £m	Cumulative exchange reserve £m	Other reserves £m	Retained earnings £m	Total £m
<b>Group</b>								
At 1 April 2007	879.8	1,421.9	158.8	(0.3)	(4.2)	24.3	254.5	2,734.8
Profit for the year attributable to equity holders	-	-	-	-	-	-	909.2	909.2
Dividends	-	-	-	-	-	-	(400.4)	(400.4)
New share capital issued	1.8	7.4	-	-	-	-	-	9.2
Post-employment benefits-actuarial losses on defined benefit schemes	-	-	-	-	-	-	(126.4)	(126.4)
Credit to equity for equity-settled share-based payments	-	-	-	-	-	-	2.6	2.6
Revaluation of investments	-	-	-	-	-	34.9	-	34.9
Fair value losses on cashflow hedges	-	-	-	-	-	(1.5)	-	(1.5)
Tax on items taken directly to equity	-	-	-	-	-	0.4	35.4	35.8
Foreign exchange adjustments	-	-	-	-	11.8	-	-	11.8
<b>At 31 March 2008</b>	<b>881.6</b>	<b>1,429.3</b>	<b>158.8</b>	<b>(0.3)</b>	<b>7.6</b>	<b>58.1</b>	<b>674.9</b>	<b>3,210.0</b>
Profit for the year attributable to equity holders	-	-	-	-	-	-	207.5	207.5
Dividends	-	-	-	-	-	-	(449.9)	(449.9)
New share capital issued	0.2	0.7	-	-	-	-	-	0.9
Post-employment benefits-actuarial losses on defined benefit schemes	-	-	-	-	-	-	(124.3)	(124.3)
Credit to equity for equity-settled share-based payments	-	-	-	-	-	-	1.0	1.0
Revaluation of investments	-	-	-	-	-	(20.3)	-	(20.3)
Fair value losses on cashflow hedges	-	-	-	-	-	(1.6)	-	(1.6)
Tax on items taken directly to equity	-	-	-	-	-	0.4	34.8	35.2
Foreign exchange adjustments	-	-	-	-	8.5	-	-	8.5
Transfer <sup>(1)</sup>	-	-	-	0.3	-	-	-	0.3
<b>At 31 March 2009</b>	<b>881.8</b>	<b>1,430.0</b>	<b>158.8</b>	<b>-</b>	<b>16.1</b>	<b>36.6</b>	<b>344.0</b>	<b>2,867.3</b>

**Note:**

- (1) On 28 July 2008, a new statutory holding company structure became effective by way of a share exchange between the shareholders of United Utilities PLC and United Utilities Group PLC and the listed parent company became United Utilities Group PLC. At that time all existing share option schemes and previous awards made by the United Utilities PLC schemes were transferred to the new listed parent company, and therefore United Utilities PLC has transferred £0.3 million to other debtors.

## Notes to the financial statements (continued)

### 23. Shareholder's equity (continued)

	Share capital £m	Share premium account £m	Treasury shares £m	Cumulative exchange reserve £m	Retained earnings £m	Total £m
<b>Company</b>						
At 1 April 2007	879.8	1,421.9	(0.3)	(1.7)	2,018.1	4,317.8
Profit for the year attributable to equity holders	-	-	-	-	1,311.3	1,311.3
Dividends	-	-	-	-	(400.4)	(400.4)
New share capital issued	1.8	7.4	-	-	-	9.2
Post-employment benefits - actuarial losses on defined benefit schemes	-	-	-	-	(30.6)	(30.6)
Credit to equity for equity-settled share-based payments	-	-	-	-	2.6	2.6
Tax on items taken directly to equity	-	-	-	-	8.6	8.6
Foreign exchange adjustments	-	-	-	0.6	-	0.6
At 31 March 2008	881.6	1,429.3	(0.3)	(1.1)	2,909.6	5,219.1
Profit for the year attributable to equity holders	-	-	-	-	813.8	813.8
Dividends	-	-	-	-	(449.9)	(449.9)
New share capital issued	0.2	0.7	-	-	-	0.9
Post-employment benefits - actuarial losses on defined benefit schemes	-	-	-	-	(20.6)	(20.6)
Credit to equity for equity-settled share-based payments	-	-	-	-	1.0	1.0
Tax on items taken directly to equity	-	-	-	-	5.8	5.8
Transfer	-	-	0.3 <sup>(1)</sup>	1.1 <sup>(2)</sup>	(1.1) <sup>(2)</sup>	0.3
<b>At 31 March 2009</b>	<b>881.8</b>	<b>1,430.0</b>	<b>-</b>	<b>-</b>	<b>3,258.6</b>	<b>5,570.4</b>

**Note:**

- (1) On 28 July 2008, a new statutory holding company structure became effective by way of a share exchange between the shareholders of United Utilities PLC and United Utilities Group PLC and the listed parent company became United Utilities Group PLC. At that time all existing share option schemes and previous awards made by the United Utilities PLC schemes were transferred to the new listed parent company, and therefore United Utilities PLC has transferred £0.3 million to other debtors.
- (2) During the year management have reviewed the cumulative exchange reserve which has resulted in the reclassification of £1.1 million to the income statement in order to more accurately reflect the nature of this balance.

166,288 (2008: 1,808,798) ordinary shares were allotted during the year ended 31 March 2009 for the exercise of options in accordance with the rules of the employee ShareSave schemes and the executive share option scheme for a total consideration of £0.9 million (2008: £9.2 million).

As permitted by section 230(4) of the Companies Act 1985, the company has not presented its own income statement. The amount of group profit for the financial year dealt with in the company's income statement is £813.8 million (2008: £1,311.3 million profit) after accounting for dividends received from subsidiary undertakings of £931.3 million (2008: £1,580.7 million) and a profit on disposal of its associate of £nil (2008: £8.7 million profit).

## Notes to the financial statements (continued)

### 24. Share capital

#### Company

	2009 number	2009 £	2008 number	2008 £
<b>Authorised</b>				
Ordinary shares of £1.00 each	1,299,999,999	1,299,999,999	1,300,000,000	1,300,000,000
Deferred A shares of £1.00 each	1	1	-	-
	<u>1,300,000,000</u>	<u>1,300,000,000</u>	<u>1,300,000,000</u>	<u>1,300,000,000</u>
<b>Issued, called up and fully paid</b>				
Ordinary shares of £1.00 each	881,787,478	881,787,478	881,621,190	881,621,190
Deferred A shares of £1.00 each	1	1	-	-
	<u>881,787,479</u>	<u>881,787,479</u>	<u>881,621,190</u>	<u>881,621,190</u>

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

### 25. Operating lease commitments

Group	Property £m	2009 Plant and equipment £m	Property £m	2008 Plant and equipment £m
<b>Commitments under non-cancellable operating leases due:</b>				
Within one year	2.6	1.1	2.2	0.9
In the second to fifth years inclusive	7.9	1.7	7.3	1.3
After five years	230.1	-	209.9	-
	<u>240.6</u>	<u>2.8</u>	<u>219.4</u>	<u>2.2</u>

In respect of the group's commitment to significant property leases, there are no contingent rentals payable, or restrictions on dividends, debt or further leasing imposed by these lease arrangements. The group has the right to renew such leases and escalation of rents is via rent reviews over a minimum five-year period.

The company has no operating lease commitments.

### 26. Share-based payments

On 28 July 2008, a new statutory holding company structure became effective by way of a share exchange between the shareholders of United Utilities PLC and United Utilities Group PLC and the listed parent company became United Utilities Group PLC (UUG). At that time all existing share option schemes and previous awards made by the United Utilities PLC schemes were transferred to the new listed parent company. From this point, all awards made by the group's schemes are in UUG shares.

Up to 28 July 2008, the company operated several share option schemes. From 28 July 2008, the operation of these schemes transferred to UUG. However, the company continues to participate in these share option schemes.

Options are exercisable at a price equal to the average quoted market price of United Utilities Group PLC's shares on the date of grant. Options are forfeited if the employee leaves the group through resignation or dismissal before the options vest.

## Notes to the financial statements (continued)

### 26. Share-based payments (continued)

Cash-settled and equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the date of grant of equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based upon the group's estimate of shares that will eventually vest.

Fair value is measured by use of both simulation and binomial models according to the relevant measures of performance. The models include adjustments, based upon management's best estimate, for the effects of exercise restrictions, behavioural considerations and expected dividend payments. The option life is derived from the models based upon these assumptions and other assumptions identified below.

The total expense included within operating profit from continuing operations, in the consolidated income statement, in respect of equity-settled share-based payments was £1.9 million (2008: £2.6 million) and £nil (2008: £nil) in respect of cash-settled share-based payments.

The United Utilities Employee Share Trust was established by a trust deed executed on 21 August 1996. The Trustees hold the trust fund for the benefit of the beneficiaries (being employees or former employees of the group's companies and their relatives) to the extent determined by the rules of the share schemes. As at 31 March 2009, the Trust held 41,418 (2008: 53,601) shares on trust and these shares will be used to satisfy awards payable under the group's performance share plan. All dividends payable on the shares during the current and prior years were waived.

Further details of the different types of share-based payments are as follows:

#### *Continuing operations*

##### **Company share option scheme 1999**

The company share option scheme 1999 is for senior executives (excluding, with effect from the introduction of the group's long-term incentive plan, executive directors and other executives participating in that plan and its successor, the performance share plan).

Options under the company share option scheme 1999 are exercisable in a period beginning no earlier than three years (five years for discounted options under the former executive share option scheme, which are no longer granted) and ending no later than 10 years from the date of grant.

##### **Employee ShareSave scheme**

The employee ShareSave scheme was available to all eligible employees and was based on Save As You Earn (SAYE) savings contracts with options exercisable within a six-month period from the conclusion of a three or five-year period as appropriate from the date of grant. Under the terms and conditions of this scheme, for every month (up to no more than six months) an employee fails to contribute the agreed monthly amount determined under the rules of the scheme, the last date exercisable will be delayed by one month. The latest grant under the ShareSave scheme was made in the year ended 31 March 2004. No further grants have been made under this scheme.

##### **Performance share plan**

The performance share plan (PSP) is for senior executives of the group. Options under the performance share plan are exercisable no earlier than three years from the 31 March preceding the date of grant and have an exercise period of three months. PSP awards granted prior to 31 March 2008 are subject to a total shareholder return (TSR) performance condition (a market-based measure of performance). PSP awards granted during the year ended 31 March 2009 onwards are 50 per cent subject to a TSR performance condition (a market-based measure of performance); the remaining 50 per cent of the awards are subject to operational performance conditions.

## Notes to the financial statements (continued)

### 26. Share-based payments (continued)

#### Matching share award plan

The matching share award plan (MSAP) is for senior executives of the group. Options under this scheme are exercisable no earlier than three years from the 31 March preceding the date of grant and have an exercise period of three months. MSAP awards are 50 per cent subject to a TSR performance condition (a market-based measure of performance); the remaining 50 per cent of the award is subject to operational performance conditions.

#### Deferred share plan

The deferred share plan (DSP) is for the employees at the level below senior executive. An annual award in deferred group shares is made on the basis of a maximum of 30 per cent of salary, apportioned according to the extent of the employee's achievement of the annual cash incentive plan maximum for the financial year. A limited number of employees at the next level below senior executive may also be nominated to receive a one-off award of a fixed number of deferred group shares in recognition of exceptional performance during the year. Shares are released after a three-year holding period and are conditional on continued employment with the group during this time.

#### Cash-settled share-based payments

The group issued, to certain employees, share appreciation rights (SARs) that require the group to pay the intrinsic value of the SARs to the employee at the date of exercise. At 31 March 2009, the group has recorded liabilities of £nil (2008: £0.2 million) in respect of SARs.

The fair value of the SARs is determined using the Black-Scholes pricing model using the assumptions detailed below. The group recorded a total charge of £nil (2008: £0.2 million expense) during the year in respect of SARs. At 31 March 2009, the total intrinsic value of the vested SARs was £nil (2008: £nil).

#### Other share-based payment plan

The main all-employee scheme is the HM Revenue and Customs approved share incentive plan, 'ShareBuy'. This is a flexible way for employees to acquire shares in United Utilities Group PLC by buying 'partnership' shares up to the lower of £1,500 or 10 per cent of taxable pay each year. The funds are deducted from pre-tax pay and passed to an independent trustee who makes a monthly purchase of shares at full market price. Employees can re-invest the dividends on partnership shares to buy more shares under the plan. The group gives one free share for every five partnership shares bought. The shares need to be held in trust for a five-year term in order to retain the maximum tax advantages.

The following tables show the inputs to the model used to calculate the fair value of equity-settled share options granted during the years ended 31 March 2009 and 31 March 2008 respectively.

	Matching share award plan TSR 50%	Matching share award plan Operational 50%	Performance share plan <sup>(1)</sup> TSR 50%	Performance share plan <sup>(1)</sup> Operational 50%	Performance share plan <sup>(2)</sup> TSR 50%	Performance share plan <sup>(2)</sup> Operational 50%
<b>2009</b>						
Weighted average exercise price (£ per share)	-	-	-	-	-	-
Vesting period (years)	2.7	2.7	2.7	2.7	2.2	2.2
Expected volatility (%)	19.0	19.0	19.0	19.0	25.0	25.0
Expected option life after adjustment for anticipated forfeiture (years)	2.7	2.7	2.7	2.7	2.2	2.2
Risk free rate (%)	4.8	4.8	4.7	4.7	1.5	1.5
Expected dividend yield (%)	6.5	-	6.5	-	6.7	-
Fair value (£ per share)	2.47	6.97	2.39	6.89	2.36	5.41

#### Notes:

(1) Awarded in August 2008.

(2) Awarded in January 2009.

## Notes to the financial statements (continued)

### 26. Share-based payments (continued)

	Matching share award plan TSR 50%	Matching share award plan Operational 50%	Performance share plan
2008			
Weighted average exercise price (£ per share)	-	-	-
Vesting period (years)	3.0	3.0	3.0
Expected volatility (%)	15.0	15.0	14.0
Expected option life after adjustment for anticipated forfeiture (years)	2.7	2.7	2.8
Risk free rate (%)	5.4	5.4	5.7
Expected dividend yield (%)	6.79	-	5.9
Fair value (£ per share)	1.43	6.62	1.84

No cash-settled share options were granted during the year (2008: £nil).

The expected volatility is based upon the historical volatility of the company's share price over the expected life of the option.

The movement in total outstanding options in respect of grants of equity instruments after 7 November 2002 unvested as of 1 April 2004, and therefore within the scope of IFRS 2 'Share-based Payments', is provided below:

	Company share option scheme 1999		Employee ShareSave scheme		Matching share award plan	Performance share plan	Deferred share plan	Cash- settled share-based payments
	Number of options	Weighted average exercise price £	Number of options	Weighted average exercise price £	Number of options	Number of options	Number of options	Number of SARs
Outstanding at 1 April 2007	237,072	5.44	969,032	4.19	-	2,783,478	-	147,518
Granted	-	-	-	-	101,367	305,868	-	-
Dividend re-investment	-	-	-	-	6,869	84,580	-	3,534
Forfeited	(22,832)	-	(22,815)	4.23	-	(240,185)	-	(3,561)
Exercised	(69,749)	5.44	(877,997)	4.19	-	-	-	-
Expired	-	-	(10,359)	4.04	-	(1,030,236)	-	(55,290)
Outstanding at 31 March 2008	144,491	5.44	57,861	4.23	108,236	1,903,505	-	92,201
Granted	-	-	-	-	147,945	270,739	229,775	-
Dividend re-investment	-	-	-	-	16,677	83,085	4,316	2,408
Forfeited	(15,381)	-	(1,114)	-	-	(48,587)	-	-
Exercised	(20,579)	6.30	(52,017)	4.90	-	-	-	-
Expired	-	-	(4,730)	-	-	(1,625,408)	-	(94,609)
<b>Outstanding at 31 March 2009</b>	<b>108,531</b>	<b>6.30</b>	<b>-</b>	<b>-</b>	<b>272,858</b>	<b>583,334</b>	<b>234,091</b>	<b>-</b>
<b>Range of prices 31 March 2009</b>		<b>6.30</b>		<b>4.90</b>				
31 March 2008		5.44		4.23				
<b>Weighted average share price at date of exercise 31 March 2009</b>		<b>6.85</b>		<b>7.05</b>				
31 March 2008		7.12		6.85				
<b>Contractual remaining life 31 March 2009</b>		<b>3.7 years</b>		<b>-</b>	<b>1.6 years</b>	<b>1.5 years</b>	<b>1.9 years</b>	<b>-</b>
31 March 2008		4.7 years		0.4 years	2.0 years	1.3 years	-	0.5 years

## Notes to the financial statements (continued)

### 26. Share-based payments (continued)

The weighted average exercise price of share options in the matching share award plan, performance share plan and deferred share plan was £nil for the year ended 31 March 2009 (2008: £nil).

None of the share options identified above as outstanding at 31 March 2009 had vested at that date.

Options outstanding at 31 March under the share option schemes which are outside the scope of IFRS 2, together with their exercise prices and dates, were:

	2009	2008	Exercise price <sup>(1)</sup> £	Normal dates of exercise
Executive share option scheme	-	26,598	8.86	2001 to 2008
	-	93,934	8.68	2001 to 2008
	127,944	182,816	7.68	2002 to 2009
Company share option scheme 1999	13,803	17,045	6.16	2002 to 2009
	111,604	146,529	6.80	2003 to 2010
	25,923	29,971	6.66	2003 to 2010
	113,653	156,691	6.52	2004 to 2011
	47,872	71,937	5.89	2005 to 2012
	201,674	257,569	6.11	2005 to 2012
	642,473	983,090		

**Note:**

(1) The exercise price equalled the market price at the date the option was granted.

#### *Discontinued operations*

##### **Vertex performance share plan (Vertex PSP)**

The Vertex PSP was for senior executives of the group. Options under the Vertex PSP are exercisable no earlier than three years from the 31 March preceding the date of grant and have an exercise period of three months. Vertex PSP awards are subject to both a TSR performance condition (a market-based measure of performance) and earnings before interest, taxation and amortisation (EBITA) and return on capital employed (ROCE) performance conditions (non-market based measures of performance).

The Vertex PSP scheme was discontinued in line with the disposal of Vertex on 26 March 2007. Accordingly, all Vertex PSP options vest no later than 31 March 2009 and the remaining charge is considered to be inconsequential.

The movement in total outstanding options in respect of grants of Vertex PSP equity instruments after 7 November 2002 unvested as of 1 April 2004, and therefore within the scope of IFRS 2, is provided below:

	Number of options	Weighted average exercise price (£)
Outstanding at 1 April 2007	893,703	-
Dividend re-investment	22,579	-
Forfeited	(7,476)	-
Expired	(345,563)	-
Outstanding at 31 March 2008	563,243	-
Dividend re-investment	14,106	-
Expired	(577,349)	-
<b>Outstanding at 31 March 2009</b>	<b>-</b>	<b>-</b>
<b>Range of prices 31 March 2009</b>		
31 March 2008		-
<b>Weighted average share price at date of exercise 31 March 2009</b>		
31 March 2008		-
<b>Contractual remaining life 31 March 2009</b>		
31 March 2008		0.7 years

## Notes to the financial statements (continued)

### 27. Related party transactions

#### Group

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

#### Trading transactions

The following transactions were carried out with the group's joint ventures:

	Sales of services		Purchases of goods and services	
	2009 £m	2008 £m	2009 £m	2008 £m
Joint ventures	109.8	130.9	11.4	3.2
	Amounts owed by related parties		Amounts owed to related parties	
	2009 £m	2008 £m	2009 £m	2008 £m
Joint ventures (see notes 15,22)	12.8	15.0	1.9	0.1

#### Non-trading transactions

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

	Interest receivable		Interest payable	
	2009 £m	2008 £m	2009 £m	2008 £m
Ultimate parent undertaking	40.5	-	2.1	-
	Amounts owed by related parties		Amounts owed to related parties	
	2009 £m	2008 £m	2009 £m	2008 £m
Ultimate parent undertaking	1,482.3	-	66.4	-

Sales of services to related parties were on the group's normal trading terms.

The amounts outstanding are unsecured and will be settled in accordance with normal credit terms. No guarantees have been given or received. A £0.1 million provision has been made for doubtful receivables in respect of the amounts owed by related parties (2008: £nil).

#### Company

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

Total dividend income received during the year amounted to £931.3 million (2008: £1,580.7 million), total interest received during the year from subsidiary undertakings was £74.7 million (2008: £17.2 million), total interest paid during the year to the ultimate parent company was £2.1 million (2008: £nil), and total recharges were £132.3 million (2008: £34.6 million). Amounts outstanding at 31 March 2009 between the parent company and subsidiary undertakings are provided in notes 15, 17 and 22.

The company has entered into performance guarantees with joint ventures as at 31 March 2009, where a financial limit has been specified of £75.3 million (2008: £73.8). The company guaranteed intra-group loans made by subsidiary undertakings of £343.9 million (2008: £nil). Balances will be settled in accordance with normal credit terms. An allowance for doubtful receivables of £80.0 million (2008: £10.1 million) has been made for amounts owed by subsidiary undertakings. In the year ended 31 March 2009, an expense of £69.9 million was recorded in respect of bad or doubtful receivables due from subsidiary undertakings (2008: £212.1 million).

## Notes to the financial statements (continued)

### 28. Cash generated from operations

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
<b>Continuing operations</b>				
Profit before taxation	568.7	478.3	781.9	1,285.4
Adjustment for investment income and finance expense	166.5	184.9	59.9	78.1
Operating profit	735.2	663.2	841.8	1,363.5
Adjustments for:				
Depreciation of property, plant and equipment	244.3	226.0	0.1	0.1
Amortisation of other intangible assets	19.2	22.2	-	-
Loss/(profit) on disposal of property, plant and equipment	0.8	(5.7)	-	-
Equity-settled share-based payments charge	1.9	2.6	0.8	2.6
Other non-cash movements	-	3.9	-	-
Profit on disposal of associate	-	-	-	(8.7)
Changes in working capital:				
Increase in inventories	(9.7)	(4.1)	-	-
(Increase)/decrease in trade and other receivables	(1,512.5)	(81.3)	(359.7)	(114.2)
(Decrease)/increase in provisions and payables	(50.1)	50.1	(277.6)	49.9
<b>Cash (used in)/generated from continuing operations</b>	<b>(570.9)</b>	<b>876.9</b>	<b>205.4</b>	<b>1,293.2</b>
<b>Discontinued operations</b>				
Profit before taxation	(1.2)	141.9		
Adjustment for investment income and finance expense	-	16.6		
Operating profit	(1.2)	158.5		
Adjustments for:				
Depreciation of property, plant and equipment	-	9.7		
Amortisation of other intangible assets	-	0.6		
Profit on disposal of property, plant and equipment	-	2.5		
Changes in working capital:				
Decrease in inventories	-	3.6		
Decrease in trade and other receivables	-	6.3		
Increase/(decrease) in provisions and payables	1.2	(36.5)		
Interest paid	-	(17.1)		
Interest received and similar income	-	10.3		
Tax paid	-	(38.4)		
<b>Cash generated from discontinued operations</b>	<b>-</b>	<b>99.5</b>		

There were no material non-cash transactions during the current or prior year affecting the group or company.

## Notes to the financial statements (continued)

### 29. Contingent liabilities

The company guaranteed loans of group undertakings up to a maximum of £1,154.2 million (2008: £418.2 million), including £810.3 million (2008: £418.2 million) relating to United Utilities Water PLC's loans from European Investment Bank and £343.9 million (2008: £nil) relating to intra-group loans made by subsidiary undertakings.

The group has entered into performance guarantees as at 31 March 2009, where a financial limit has been specified of £119.8 million (2008: £121.6 million).

The company has entered into performance guarantees as at 31 March 2009, where a financial limit has been specified of £114.4 million (2008: £106.5 million).

### 30. Events after the balance sheet date

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2009.