Registered No: 2366678

United Utilities Water PLC

Report and Financial Statements

31 March 2013

Contents

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

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

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

Chairman’s and Chief Executive Officer’s statement

Strategy

We are pleased to report that we have made good progress during the year towards our vision of becoming a leading North West service provider and one of the best UK water and wastewater companies, as we aim to deliver the best service to customers, at the lowest sustainable cost and in a responsible manner. We have delivered a third year-on-year improvement in customer satisfaction, underpinned by good operational and environmental performance and remain on course to deliver our regulatory outperformance targets. We do, however, recognise that we have more to do to achieve our vision and we see considerable opportunities to deliver further improvements.

The UK Government’s reform agenda for our sector is providing new opportunities for the company. The adoption of private sewers, which almost doubled the size of our wastewater network, went well. In anticipation of this change we revised our approach to management of our wastewater network and this has delivered higher levels of customer satisfaction at a slightly lower cost than originally estimated. We are also active in the expanding retail water market for business customers; we have won customers in Scotland and have a significant pipeline of further opportunities. Water and sludge trading are both opportunities that we are exploring with our regulators in discussions aimed at developing ideas tabled under the UK Government’s reform agenda.

The North West presents a unique set of challenges for the company, containing areas of outstanding natural beauty, a long coastline supporting tourism and a significant proportion of the UK’s remaining industrial base. Our plans must maintain a challenging balance between the needs of our customers and the natural environment. We recognise that we operate in a region characterised by high levels of socio-economic deprivation and that our future plans must take account of our customers’ ability to pay a fair price for our services, particularly in these difficult economic times. Increasingly, our plans will be delivered through partnerships such as ‘Turning Tides’; a partnership between the company, the Environment Agency, local authorities and other stakeholders to address improvements in North West bathing water quality to meet new European standards.

A fair deal to customers

We have continued to invest in our people, assets, systems and processes to improve the service our customers can expect of us. We expect to reinvest around £200 million of capital expenditure outperformance over the 2010-2015 period, benefiting our customers and the environment.

We have implemented active pressure management in our water network to reduce bursts and leakage, helping us to meet or outperform our leakage target again. Should we have a burst, the additional investment completed during the year in strategic mains refurbishment and connectivity has improved the capability of our water network to maintain supply. We have again achieved a high level of water quality compliance throughout the year.

Whilst the North West did not experience the hosepipe bans seen elsewhere in the country last spring, rainfall across the region was much lower than expected. We were able to benefit from our investment in an integrated regional water network to keep customers supplied throughout the dry period. We are considering extending our integrated network to include the north west of Cumbria thereby improving security of supply to this area.

In contrast, the latter half of 2012 was characterised by a large number of exceptionally high rainfall events and this proved to be a testing time for our wastewater assets. We continued to invest heavily in schemes designed to mitigate the risk of flooding of our customers’ homes and to improve river and bathing water quality, such as our £100 million+ project in Preston. Our operational and environmental focus is delivering results and we were pleased to achieve our best performance for many years in the Environment Agency’s operational performance metrics.

Chairman’s and Chief Executive Officer’s statement

Our wastewater network will continue to benefit from significant investment going forward as we adapt to weather patterns likely to result from climate change.

The North West contains over half of the one per cent most deprived areas in England and we recognise the financial difficulties many of our customers face. We are supporting customers in these tough economic times through a portfolio of measures to help those struggling to pay their water bills, including a payment of £5 million by the UUG group to our charitable trust. Our support measures and emphasis on helping customers back onto manageable payment plans has enabled us to contain levels of bad debt and so decrease the cost burden on all our customers.

We have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. We have delivered a number of improvements throughout the year and were pleased to see this reflected in a significant improvement in customer satisfaction for the third successive year. We were also pleased to see the results of our brand tracker survey which rated us highly against 10 leading service providers operating in the North West. Notwithstanding good progress, we could have done more to prevent the need for unnecessary contacts from our customers and we will continue in our efforts to improve further our service and responsiveness.

Investing for performance

Capital investment in our assets was accelerated in 2012/13 to deliver a number of beneficial projects early and reduce the risk associated with projects due to be delivered in the last two years of the 2010–15 period. Investment of £787 million in the year is up on last year’s spend of £680 million. We have now invested over £2 billion in the first three years of the 2010–15 period, and we remain on track to deliver our planned five-year investment programme.

Our investment programme represents a significant contribution to the North West economy. Our capital investment of around £3.5 billion over the 2010–15 period provides an estimated £7 billion boost to the region’s economy, supporting 9,000 jobs, and securing a legacy for the future. As we look ahead to the next price review, we are actively engaging with our customers and stakeholders to help address their needs and to shape our plans for the period 2015 to 2020.

A changing regulatory landscape

The UK Government published a draft Water Bill in July 2012, proposing the expansion of retail competition and the introduction of wholesale, or upstream, competition. We, along with various interested parties, submitted our response to these proposals to the Environment, Food and Rural Affairs (Efra) Select Committee and we await publication of the UK Government’s Water Bill with interest.

Following a period of constructive dialogue with Ofwat, we were pleased to accept the revised licence modification proposals which were published by the regulator on 21 December 2012. These revised licence proposals focus on the changes required to facilitate the forthcoming 2014 price review (PR14).
Ofwat published its PR14 methodology consultation in January 2013 and we submitted our response to Ofwat in March.

In preparation for this more competitive environment and to align with the separated price controls, with effect from April 2013 we have revised our structure and activities around three business areas: Wholesale; Domestic Retail; and Business Retail.

Chairman's and Chief Executive Officer's statement

Our employees

The people in United Utilities are key to the delivery of the highest levels of service to our customers and we would like again to thank them for their dedication and continued hard work during the year. We strive to continuously improve our safety culture and we have implemented a number of initiatives throughout the year. We launched our employee guide for health and safety responsibilities and introduced a set of behavioural standards at our main office sites, called the 'Safety Six'. Health and safety will remain a significant area of focus for us.

A committed, capable and motivated workforce is central to delivering our vision and we remain fully focused on maintaining high levels of employee development and engagement. We are always looking for the best and the brightest talent and we are pleased to say that we extended our apprentice programme during the last year. We currently employ over 80 apprentices and plan to recruit up to 40 apprentices each year through to at least 2015. Alongside this, we are continuing to expand our graduate recruitment scheme, with plans to add over 20 graduates in 2013/14 in addition to more than 35 we currently employ.

Our board

Our plc structure and governance standards ensure that our board and non-executive directors continue to provide sound and prudent oversight in compliance with the principles of the UK Corporate Governance Code. In addition, we are the only UK water company to have achieved and retained 'World Class' status in the Dow Jones Sustainability Index over the last five years, reflecting our high standards of governance. Indeed, we are one of only two water companies globally to reach this high standard.

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

We are pleased to welcome Brian May to the board as a non-executive director following his appointment last September. Brian is also finance director at Bunzl plc. His expertise will be an asset to the board and he will replace Paul as chair of both the UUG audit and risk committee and the treasury committee.

Outlook

We believe that our sustained focus on customer satisfaction and operational performance is delivering results for customers, our shareholder and our other stakeholders. We continue to be on track to meet our regulatory outperformance targets, with substantial financing and operating outperformance already secured. Our capital structure remains robust and we have a sustainable dividend policy that targets real growth through to at least 2015.

Looking ahead, our focus remains centred on driving further customer satisfaction, alongside operational and environmental improvements and we believe there is still plenty of scope to achieve this. We are now preparing our business plan for the next Price Review, as we aim to address the needs of our stakeholders, support the environment and our regional economy, while recognising the need to keep bills affordable for our customers.

Dr JDG McAdam
Chairman
4 June 2013

SL Mogford
Chief Executive Officer
4 June 2013

Business review

Our business model and strategy

Our industry

Every day, over 50 million household and non-household consumers in England and Wales receive water and wastewater services. There are currently 10 licensed companies which provide both water and wastewater services to consumers in their respective regions. Additionally, there are licensed companies which provide water only services and tend to be smaller in size. As each company in the water sector operates as a regional monopoly for the majority of its services, they are subject to regulation in terms of both price and performance.

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

Our customers

We provide services to approximately three million households in our region and this generates around two-thirds of our total revenues. We also serve approximately 200,000 businesses, ranging in size from large manufacturing companies down to small shops. Our households pay just over £1 per day on average for the combined water and wastewater services we provide. Over the 2010–15 period, our customers' average annual bill will fall by £9 before the impact of inflation. Our objective is to continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment at a price to customers that represents good value for money.

We are continuing to invest in our assets and systems for the benefit of our customers. During the five-year period to 2015, we have a capital investment programme of approximately £3.5 billion. We would again expect a substantial investment programme for the 2015–20 period as we strive to further improve service and meet stringent environmental obligations. Capital investment in the 2015-20 period will help us deliver our five promises to our customers:

- to provide great water;
- to remove wastewater;
- to protect and enhance the environment;
- to provide customer service they can rely on; and
- to deliver value for money.

Water and wastewater operations

Almost 2,000 million litres of water is supplied every day to approximately 3.2 million homes and businesses. Water is collected from catchment land and other sources and stored in reservoirs before being treated and then delivered via a network of pipes to homes and industry.

A large proportion of the water supplied flows freely by gravity and does not need to be pumped, reducing energy consumption and the carbon impact on the environment. Wastewater is collected using a network of sewers and treated before being returned safely to the environment. A by-product of the treatment of wastewater is sewage sludge, which is treated further to produce an end product suitable for safe disposal while providing renewable energy generation.

Business review (continued)

Regulatory environment

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

Economic regulation

Economic regulation is the responsibility of an independent body, Ofwat, whose primary duties are:

- to protect the interests of consumers, wherever appropriate by promoting effective competition;
- to ensure that companies properly carry out their functions; and
- to ensure that companies can finance their functions.

As part of its periodic review Ofwat sets limits on the average annual increase in charges that a water company can impose across each price control period (usually five years).

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

An allowed return on the RCV is set by Ofwat to ensure water companies can secure a reasonable return on their capital in order to finance their functions. Operating costs (subject to an efficiency target) as well as depreciation and tax are added to this allowed return. In addition, adjustments depending on each company's relative performance are added or deducted to derive the allowed revenue for each water company. Based on each company's calculated allowed revenue across the regulatory period, Ofwat publishes annual price limits in its final price determination. The price limits for each company are set by reference to inflation as measured by the retail prices index (RPI), plus an adjustment factor known as 'K'.

Ofwat's approach to setting price limits for the 2010 – 2015 regulatory period:

Regulatory capital value (RCV)
x
Allowed return
+
Operating expenditure plus depreciation for an efficient company
+/-
Performance related adjustments
+
Taxation
=
Ofwat allowed revenues and overall price limit, K

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

Business review (continued)

Our current price limits (published November 2009)

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

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

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

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

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

Environmental and quality regulation

The water and wastewater industry in the UK is subject to substantial domestic and European Community regulation, placing significant statutory obligations on water and wastewater companies with regard to, amongst other factors, the quality of treated water supplied, wastewater treatment and the effects of their activities on the natural environment. All water and wastewater companies have a general duty to exercise their powers to protect and, where appropriate, enhance the natural environment and to promote the efficient use of water. Environmental regulation is the responsibility of the Secretary of State for Environment, Food and Rural Affairs together with:

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

Future regulation

In January, Ofwat published its methodology statement which provides a roadmap for the 2015–20 price review period. This statement confirmed that there will be separate price controls for water companies' wholesale water, wholesale wastewater, retail household and retail business operations, whereas currently there is only one overall price control.

Separate retail price controls aim to provide retail businesses with greater incentives and focus on delivering efficient service to business customers as competition expands and also to household customers under a new average cost to serve approach. This proposed retail household model allows water companies to only charge its customers an amount based on the average costs of the industry, although the details of how this will be implemented are still being discussed. Ofwat is safeguarding investment in the sector by protecting the existing asset base of companies, allocating all RCV to the wholesale business. It is also refining the way companies' operating and capital costs are assessed to encourage companies to utilise the most efficient, sustainable solutions under a new 'totex' model.

Business review (continued)

Greater emphasis is being placed on customer views and we are already embracing this approach, actively engaging with our customers to shape our business plan to meet their needs. Ofwat is also encouraging more flexible and sustainable use of water by increasing the incentives to trade water between regions as there has been little water trading between companies to date.

We, along with other stakeholders, submitted a response to Ofwat's methodology consultation in March. A final methodology statement is expected to be published by Ofwat this summer. We are already in the process of preparing our draft business plan for the 2015–20 period and we are scheduled to present this to Ofwat in December 2013. Ofwat is planning to publish its final determination for the 2015–20 period by the end of 2014. Further developments in the environmental and quality regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive and the revised Drinking Water Directive). The Water Bill, announced in the Queen's speech on 8 May 2013, will also affect the regulatory environment in which we operate.

Regulatory risks

Given the complex legal and regulatory environment within which we operate, there are a range of risks to which we are exposed. Risks can be in the form of possible non-compliance with existing laws or regulations or failure to meet the terms of our current 2010–15 regulatory contract. We also face risks in relation to potential future changes in legislation or regulation, particularly with regard to the 2015–20 price review period.

Competitive environment

Competitors

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

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

In line with our aspiration to be one of the leading service providers in the North West, we benchmark our customer service performance against other large service providers in the region.

Direct competition

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

New appointments or variations

A new appointment or variation is made when an existing undertaker is replaced by a new undertaker as the supplier of water and/or wastewater services for a defined area. Instances of new appointments or variations have been relatively rare, with less than 50 granted across the industry since privatisation in 1989.

Water supply licensing

Water supply competition was opened up in December 2005, when very large non-household customers (those with an annual consumption of at least 50 megalitres of water a year at each site) were allowed to choose their water supplier. A water undertaker is obliged to allow a licensed water supplier to use its network for this purpose, subject to payment of charges and certain conditions and rights of refusal.

Business review (continued)

In December 2011, this market was opened up further, with the threshold being reduced to five megalitres a year. To date very few customers have switched supplier in England and Wales.

Future competition

Looking ahead, the UK Government's Draft Water Bill, published in July 2012, proposed that the water supply threshold will be reduced further to zero for non-household customers and also be expanded to include sewerage as well as water services, with a target date of 2017 at the earliest. This will effectively open up retail competition for all business customers. The UK Government has not expressed any intention to expand competition to include household customers.

We are exploiting the opportunity presented by the expansion of retail competition for business customers and have already assembled a strong team. We have applied for and secured a licence to operate in Scotland and we have won our first customers there. We have a strong pipeline of further opportunities and look forward to developing our position outside of our region as the market opens in England.

The Draft Water Bill also proposed the future introduction of wholesale, or upstream, competition (for example the input of raw or treated water into a water company's network or the removal of wastewater for treatment). Scrutiny of the draft bill by the Efra Select Committee provided the opportunity for all interested parties to comment on the draft bill's provisions. The Select Committee published its report on the draft bill in February 2013 and we now await the Government's Water Bill with interest.

Economic environment

UK gross domestic product has continued to stagnate during 2012/13 and the equity markets experienced another volatile year, albeit boosted as concerns over the European debt crisis have abated somewhat recently. Bond yields have remained at relatively low levels throughout 2012/13. This has been beneficial to our future cost of debt as in March 2013 UUW raised a new £100 million, 10-year index-linked bank loan and as we continued with our 10- year rolling interest rate hedge strategy.

While RPI inflation has come down from the very high levels seen over the previous two financial years (peaking at 5.6 per cent in September 2011), it has remained higher than the long-term trend. Our revenues and asset base are linked to inflation, so the high recent levels of inflation have increased our reported revenue and RCV. We also have a large quantity of index-linked debt which means our finance costs increase as inflation rises, providing a partial economic offset to revenue, although it should be noted that both revenues and financing costs are based on differing lagged measures of inflation and so do not provide a perfect hedge. Higher RPI inflation can also lead to operating cost pressures as a number of our costs have either direct or indirect links to inflation.

The North West of England continues to face a particularly tough economic environment. The North West unemployment rate, having increased by more than any other UK region in 2011/12, remained above the national average, at 8.0 per cent for the quarter ending March 2013, compared to 7.8 per cent nationally. A report 'Department for Communities and Local Government, Indices of Deprivation 2010', published in March 2011, highlighted that the North West had more of the most deprived areas in England than any other region.

Commercial volumes have shown a downward trend in recent years, impacted by the persisting tough economic climate. Bad debt also remains a risk to which we are exposed, although Ofwat currently recognises this through a special factor allowance. Debt management continues to be a significant area of focus for us as we seek to use best practice in the recovery of debt and in helping customers back into making regular payment through use of manageable payment plans.

Our approach to doing business

We believe that responsible business should be embedded within everything we do and this should be evident across all of our activities.

Business review (continued)

We are committed to delivering our services in a responsible way and our approach to responsible business practice is set out in our Business Principles document. This states that for United Utilities, being a responsible business means:

- Providing a great service to our customers
- Working to protect and enhance our environment
- Actively supporting our local communities
- Supporting our employees to achieve their full potential in a safe workplace
- Delivering good value to our stakeholders and managing our supply chain fairly

We've explained these in more detail below:

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

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

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

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

Delivering good value: We are committed to honouring our responsibility to our shareholders, credit investors and those who provide us with goods and services. We aim to operate as effectively as possible at the lowest sustainable cost and to retain a robust and sustainable financial profile to provide enduring shareholder value. We work with suppliers whose business principles, conduct, and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, supporting us in the delivery of wider social, economic and environmental benefits. This annual report provides a comprehensive financial and operational review to help inform our investors of our performance.

Running our business with integrity

Given the long life of our infrastructure, we take a long-term view of our operations and our aim is to deliver our strategic objectives in a responsible, sustainable way. Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. Our UUG board-level CR committee develops and oversees our CR strategy and this continuing focus helped the group retain our Dow Jones Sustainability Index 'World Class' rating and our 'Platinum Big Tick' ranking in the Business in the Community CR Index. Details of our responsible business performance for the year can be found on our website at: corporate.unitedutilities.com.

Business review (continued)

Key value drivers

We create value principally by delivering our regulatory contract. This means meeting Ofwat's allowances on operating, financing and capital expenditure and achieving our required customer outcomes while avoiding penalties. In the current 2010–15 period, we are delivering a substantial capital investment programme of approximately £3.5 billion, providing benefits for our customers and the environment. This, along with RPI inflation, grows the RCV or asset base of our business.

Outperforming the regulatory contract, by delivering the requirements for less than Ofwat has allowed, creates further value. Conversely, poor performance, such as not delivering the requirements on time to specification or in an inefficient manner, can reduce the value creation. Growth in shareholder value is a combination of share value appreciation and dividends paid. Share value appreciation relates to growth in the RCV. Our disciplined investment approach in growing the RCV helps support the retention of a robust capital structure and sustainable real growth in the dividend.

Operating in the North West region, the number of customers we serve is relatively stable. The main driver to revenue is the allowed change in price we charge our customers, which is determined by Ofwat's price control model. There will also be some impact due to changes in consumption from our metered customers and over recent years, in the persisting tough economic conditions, consumption has shown a downward trend, particularly for our business customers.

We aim to deliver customer benefits and long-term shareholder value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner.

Best service to customers

It is important for our business to perform well operationally and customer focus is one of our core values. Providing the best service to our customers will help us to strengthen our reputation and help us improve our efficiency. It will also ensure we are in a strong position to compete as the business market for retail customers evolves. Ofwat can also apply financial incentives or penalties depending on our performance, both absolute and relative to our peers, such as its customer service measure, SIM.

The regulator can also require us to incur additional unfunded expenditure if, for example, we are not adequately sustaining our assets through its serviceability assessment.

Ofwat's SIM measure – key value driver

Our customer experience programme, first established in 2010/11, has helped us to better understand the needs and issues of our customers and we have introduced a range of initiatives to drive performance improvements in this area and we have many more in the pipeline. Having been in last place of the water companies under Ofwat's SIM measure at the start of the regulatory period, we are targeting a top quartile position in the medium-term. 2013/14 is the final year of three over which companies' SIM scores will be measured for the purpose of penalties or rewards at the next price review and we are committed to achieving the best position we can by the end of this final measurement year.

Lowest sustainable cost

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

Operating costs are the largest expense to our company and minimising our costs across areas such as employee costs, power, materials, property rates and service costs is important in order to add value to our company. However, minimising costs needs to be done on a sustainable basis and not to the detriment of customer service or long-term value. We have a strong focus on innovation to help optimise the management of our assets and networks, which helps us identify and resolve operational issues before they impact the customer, thereby also improving our efficiency.

Business review (continued)

In terms of financing costs, Ofwat allows all water companies an industry-wide fixed return on debt over the regulatory period in order to efficiently finance their businesses. For the 2010–15 period, this was set at 3.6 per cent plus inflation (pre tax). We can generate financing outperformance by locking in a lower cost of borrowing than this assumed rate. At each price review, Ofwat takes account of the rates at which companies have raised debt, along with other factors. At the last price review in 2009, Ofwat reduced allowed returns, which is providing a beneficial impact on customer bills during the current regulatory period.

Outperformance of regulatory contract – key value driver
Through an efficient capital structure, supporting a solid A3 credit rating from rating agency Moody's, we aim to secure debt at a lower average rate than Ofwat's cost of debt allowance for the 2010–15 period. Through the effective implementation of our cost control measures, we are targeting operating expenditure outperformance over the 2010–15 period on top of a tough £150 million efficiency challenge from Ofwat. Through our disciplined investment approach, we aim to achieve capital expenditure outperformance compared to the 2010 – 2015 regulatory allowance.

Responsible manner

We are acutely aware of our responsibility to the environment and we are committed to delivering our services in a responsible and sustainable manner. This approach not only provides environmental benefits, but is important for our reputation and helps the delivery of sustainable profits. Our regulators can require us to incur additional unfunded expenditure if, for example, we fail to meet our leakage targets or can issue fines if we fail to meet certain environmental targets.

We know that the success of our business is driven by the talent, engagement and commitment of our employees. We respect the rights of our people and enable everyone to make their best contribution. We provide competitive rewards to attract and retain employees and recognise high achievement alongside investing in our employees' learning and development.

Leakage performance – key value driver
Our strong, year round operational focus on leakage has enabled us again to meet our annual leakage target, as set by Ofwat, making us one of the best performers in the industry. As well as the water resource and customer supply benefits, this has ensured we have avoided any unfunded expenditure requirements from our regulators and we are targeting to continue to meet this leakage target every year going forward.

Financial and operational performance

Key performance indicators

The company monitors a large number of financial and operational key performance indicators (KPIs) to enhance the visibility of its performance and to help drive improvements. Performance in 2012/13 against these KPIs is set out in the table below.

	2013	2012
Financial KPIs		
Turnover	£1,604.7m	£1,534.9m
Operating profit	£635.3m	£596.7m
Profit before tax	£311.4m	£243.7m
RCV gearing	64%	65%
Interest cover	2.4	2.2

Business review (continued)

Financial performance

Turnover

The company has delivered a good set of financial results for the year ended 31 March 2013. Turnover increased by £69.8 million to £1,604.7 million, principally reflecting a 5.8% nominal (0.6% real price increase plus 5.2% RPI inflation) regulated price increase, partially offset by reduced volumes and the on-going impact of customers switching to meters. The impact of meter switching was in line with our expectations while commercial and domestic volumes continued to be impacted by the persisting tough economic climate. We would expect to recover a substantial element of any regulated turnover shortfall through the regulatory methodology.

Operating profit

Operating profit increased by 6% to £635.3 million, primarily as a result of an increase in turnover and a reduction in exceptional operating costs, offset by an expected increase in depreciation, power and other operating costs.

Profit before taxation

Profit before taxation was £311.4 million, £67.7 million higher than last year primarily due to the £38.6 million increase in operating profit discussed above and a £29.1m reduction in finance expenses mainly due to fair value losses.

Cash flow

Net cash generated from continuing operating activities for year ended 31 March 2013 was £987.2 million, compared with £895.1 million last year. This mainly reflected a reduction in the total pension contribution payments between the two years. The company's net capital expenditure was £758.3 million, principally in the regulated water and wastewater investment programmes.

Net debt including derivatives at 31 March 2013 was £6,030 million, compared with £5,630 million at 31 March 2012. This expected increase reflects expenditure on the regulatory capital expenditure programmes and payments of dividends, interest and taxation, alongside the accelerated pension deficit repair payments and an increase in the principal of our index-linked debt, partly offset by operating cash flows.

Debt financing and interest rate management

Gearing (measured as company net debt divided by company's regulatory capital value) marginally decreased to 64% at 31 March 2013, compared with 65% at 31 March 2012, and is within Ofwat's 55% to 65% assumed gearing range. The company now has a pension surplus of £29.3 million, compared with a deficit of £31.1 million as at 31 March 2012.

At 31 March 2013, UUW had long-term credit ratings of A3/BBB+ from Moody's Investors Service and Standard & Poor's Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. In December 2012, Standard & Poor's put the company's rating on a positive outlook, citing improving financial metrics and operational performance.

In March 2013, UUW arranged a new £100 million, 10-year index-linked loan with an existing relationship bank. The company also renewed £130 million of existing bank facilities in the period. The company has headroom to cover its projected financing needs into 2015.

The UUG group has access to the international debt capital markets through its €7 billion euro medium-term note programme which provides for the periodic issuance by United Utilities PLC and UUW 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.

Business review (continued)

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

Long-term sterling inflation index-linked debt is the company's preferred form of funding as this provides a natural hedge to assets and earnings. At 31 March 2013, approximately 47% of the company's net debt was in index-linked form, representing around 31% of UUW's regulatory capital value, with an average real interest rate of 1.7%. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the company's average term debt maturity profile which is in excess of 25 years.

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

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

Liquidity

Short-term liquidity requirements are met from the company's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. In addition to the UUG group's €7 billion euro medium-term note programme, the UUG group has a €2 billion euro-commercial paper programme, both of which do not represent funding commitments.

In line with the board's treasury policy, UU aims to maintain a robust headroom position. Available headroom at 31 March 2013 was £254 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover the company's projected financing needs into Autumn 2014.

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

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

Pensions

As at 31 March 2013, the company had a net retirement benefit, or pension, surplus of £29.3 million, compared with a net pension deficit of £31.1 million at 31 March 2012. This £60.4 million positive movement principally reflects payments of £52.1 million in respect of accelerated, previously agreed, deficit repair contributions, payments under the inflation funding mechanism and investment returns exceeding expectation. Following the accelerated deficit repair contributions paid in the first half of 2012/13, the company completed early all scheduled deficit repair payments through to March 2015.

The group has sought to adopt a more sustainable approach to the delivery of pension provision and prior to the start of the 2010-15 regulatory period amended the terms of its defined benefit pension schemes.

Business review (continued)

UU stated previously that it would continue to evaluate its pensions investment strategy to de-risk further its pension provision and introduced an inflation funding mechanism, which facilitates a move to a lower risk investment strategy. This allowed UU to reduce the allocation of its pension assets to approximately 22% in equities and other high risk assets. In addition, UU has adopted the use of more prudent longevity assumptions. Over the last two financial years, the company also progressively increased its interest rate hedge and this has now been extended to around 90% of the pension scheme liabilities. Although any additional payments under the inflation funding mechanism would reduce financing outperformance, there would be a positive benefit to the pensions surplus or deficit position.

From an accounting perspective, FRS 17 'Retirement Benefits' treats the inflation funding mechanism as a schedule of contributions rather than a pension scheme asset. This means that the liabilities position can change to reflect a change in market expectations of long-term inflation, without a commensurate movement in assets. This accounting treatment means that there is likely to be a degree of volatility in future FRS 17 pension valuations.

The last actuarial valuations of the United Utilities Pension Scheme and the United Utilities PLC Group of the Electricity Supply Pension Scheme were carried out as at 31 March 2010. The valuations are performed on a triennial basis, and therefore discussions will take place over the coming months between the company and the trustees regarding the basis of the 31 March 2013 valuations. The actuarial valuations are based on scheme specific factors which may result in a different assessment of the pension schemes' position to the FRS 17 numbers reported in the company's financial statements.

Further detail is provided in note 21 ("Retirement benefits") of these financial statements.

	2013	2012
Operational KPIs		
Best service to customers		
Serviceability [1]	1 x improving 3x stable	1x improving, 2x stable, 1x marginal
Service incentive mechanism – qualitative (relative) [2]	14	16
Service incentive mechanism – quantitative (absolute) [3]	179	273
Lowest sustainable cost		
Opex outperformance (2010-15 target of at least £50m)	On track	On track
Financing outperformance (2010-15 target of at least £300m)	On track	On track
Capex outperformance (2010-15 target to meet regulatory allowance)	On track	On track
Responsible manner		
Leakage – rolling average annual leakage	457Ml/d - Met target	453Ml/d - Met target
Environment Agency performance assessment [4]	3rd	7th
Dow Jones Sustainability Index rating	'World Class'	'World Class'

(1) 2012/13 ratings subject to regulatory assessment.

(2) Performance relative to 21 water companies.

(3) Low number indicates good performance. 2012/13 number subject to regulatory audit.

(4) Performance relative to 10 water and wastewater companies and relating to 2011/12, being the latest available assessments from the Environment Agency.

Business review (continued)

Operational performance

Supporting our drive to improve operational performance, last year we put in place a revised management structure with a strong focus on accountability and delivery. We moved from our previous functional structure, to an organisational structure where managers are responsible for end-to-end delivery of capital projects and operational performance within their respective regions, providing a more integrated approach. We have refined our organisational structure further in preparation for a more competitive environment and to align with the separated price controls that will apply at the 2014 price review. With effect from April 2013, we have revised our structure and activities around three business areas: Wholesale; Domestic Retail; and Business Retail.

We continue to make good progress towards our objective of becoming a leading North West service provider and one of the best UK water and wastewater companies. We are pleased to have been consistently ranked third out of ten leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. We are behind Marks & Spencer and John Lewis, but ahead of seven other major organisations covering utilities, telecoms, media and banking services. We have made further operational improvements during the year and have improved our performance relative to our water sector peers.

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

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

Best service to customers

We believe in delivering a fair deal for our customers and have continued to invest in our people, assets, systems and processes to improve the service our customers can expect of us. In addition, we expect to reinvest around £200 million of capex outperformance over the 2010-15 period for the benefit of our customers and the environment.

Robust water supply and reliability – We have implemented active pressure management in our water network to reduce bursts and leakage, helping us to meet or outperform our leakage target. Should we have a burst, the additional investment completed during the year in strategic mains refurbishment and connectivity has improved the capability of our water network to maintain supply. Whilst the North West did not experience the hose-pipe bans seen elsewhere in the country last spring, rainfall across our region was much lower than expected. We were able to benefit from our investment in an integrated regional water network to keep customers supplied throughout the dry period. Overall, our customers continue to benefit from our robust water supply and demand balance and high levels of water supply reliability. We have again achieved a high level of water quality, with mean zonal compliance continuing to be over 99.9%.

Investing to mitigate sewer flooding – The latter half of 2012 was characterised by a large number of exceptionally high rainfall events and this proved to be a testing time for our wastewater assets. We were disappointed to miss our Ofwat target in respect of the number of sewer flooding incidents, but have continued to invest heavily in schemes designed to mitigate the risk of flooding of our customers' homes. Our wastewater network will continue to benefit from significant investment going forward as we adapt to weather patterns likely to result from climate change.

Improving customer service performance – We have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. This has helped us deliver further improvements in our performance on Ofwat's service incentive mechanism (SIM), reflecting our continuing strong focus on dealing with customer enquiries.

Business review (continued)

The number of customer complaints made to the Consumer Council for Water (CCW) in 2012/13 has reduced by a further 11%, compared with 2011/12. We are pleased to report that the total number of escalated complaints assessed by the CCW was zero in the 2012/13 financial year, which is the first time we have achieved this. This has helped us improve our SIM performance further, as detailed in the KPIs section below, although our qualitative SIM score for the last quarter of 2012/13 saw us slip back against the trend achieved in the first three quarters. We ended the year in 14th place in the sector on this measure, up two places on the previous year. Encouragingly, we have recently received our qualitative SIM score for the first quarter of 2013/14 and we achieved 10th position out of the 21 water companies.

Asset serviceability – We have a range of actions to help support the serviceability of our assets. We are improving the robustness of our water treatment processes, refurbishing service reservoir assets, continuing with our comprehensive mains cleaning programme and are optimising water treatment to reduce discoloured water events. To help reduce sewer flooding, the actions include incident based targeting to focus on areas more likely to experience flooding, effective intervention in cleaning and rehabilitation or refurbishment of sewers and advising customers about items not suitable for sewer disposal. Our programme also includes defect identification through CCTV sewer surveys, along with continual improvement of wastewater reporting systems to enable real time operational information to be made visible at all management levels and promote early intervention. Our comprehensive range of actions has helped us meet our water and wastewater serviceability standards, as detailed in the KPIs section.

Retail competition for business customers – We have been building our capability to help ensure we are in a strong position to compete as the business market for retail customers evolves. We secured a water supply licence in 2012 to compete in Scotland and have built a team with a deep retail background in the utility and commercial sectors. Although the financial benefits from retail activities are relatively small at this stage, the market will evolve and business customers are looking for services over and above meter reading and billing. We are delivering a range of value-added services, such as on-site engineering solutions and water efficiency advice. We are pleased to have extended our presence and have now won several business customers outside of our region. We also have a significant pipeline of opportunities, a number of which are multi-site customers.

Improving customer service remains a significant area of continued management focus and we see plenty of opportunity to deliver further benefits for our customers.

Key performance indicators:

- **Serviceability** – Long-term stewardship of assets is critical and Ofwat measures this through its serviceability assessment (Ofwat defines serviceability as the capability of a system of assets to deliver a reference level of service to customers and to the environment now and in the future). Our range of actions has helped us return our wastewater infrastructure assets to a ‘stable’ rating, from a ‘marginal’ rating, and we are now meeting our serviceability standards. We are currently assessed as ‘improving’ for our wastewater non-infrastructure assets and ‘stable’ for our water infrastructure, water non-infrastructure and wastewater infrastructure assets. The aim is to continue to hold at least a ‘stable’ rating for all four asset classes, which is aligned with Ofwat’s target.
- **Service incentive mechanism (SIM)** – UU made significant progress on Ofwat’s combined SIM assessment for 2011/12, moving up five places to 16th of the 21 water companies, compared with 2010/11. This represented the largest overall SIM score improvement in the industry. Further progress has been made in 2012/13, with a quantitative score of 179 points, representing a further 34% improvement compared with 2011/12. On the qualitative measure, UU has improved its 2012/13 average score by 0.25 points to 4.43 points, moving up two further places to 14th position, which represents 6th place among the ten water and sewerage companies. Our continued progress is encouraging, as we aim to move to the first quartile in the medium-term.

Business review (continued)

Lowest sustainable cost

We are continuing to implement a wide range of initiatives to help optimise our performance and deliver sustainable efficiencies.

Materials – Our asset optimisation programme continues to provide the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power assets to generate renewable energy.

Proactive network management – We are implementing a more proactive approach to asset and network management, with the aim of improving our modelling and forecasting to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving efficiency.

Energy costs – We have substantially locked in the cost of our power requirements through to 2014/15, via hedging, securing outperformance. Although power unit costs for 2013-15 have been secured at higher levels than those for 2011/12, this still delivers additional outperformance versus the regulatory contract.

Debt collection – We are continuing to enhance our proactive approach to debt collection and are implementing a detailed action plan. The North West faces a particularly tough economic environment, with unemployment having increased at a faster rate than any other UK region in 2011/12, particularly in the second half, resulting in an adverse impact on customers' ability to pay this year. Although North West unemployment improved in 2012/13, its remains higher than the position at March 2011 and is still above the national average. We recognise the financial difficulties facing many of our customers and provide a range of options to help our customers who are struggling to pay their bills, including our charitable trust, and we have helped many customers back onto manageable payment plans. Despite the tough economic climate, our range of actions have helped us to again deliver a good performance and we have sustained bad debts at 2.2% of regulated revenue for 2012/13, consistent with last year.

Pensions – UU placed its pension provision on a more sustainable footing in 2010 and has subsequently taken additional steps to de-risk the pension scheme further, with the group now benefiting from a pension surplus.

Capital delivery – The business is strongly focused on delivering its commitments efficiently and on time and has a robust commercial capital delivery framework in place for the 2010-15 period. We have improved our internal Time: Cost: Quality index (TCQi) score from around 50% in 2010/11 to approximately 90% in 2012/13. This means we have met our target two years ahead of schedule and we are firmly focused on sustaining this substantial improvement. This helped us accelerate our capital programme to help optimise capital delivery and reduce risk towards the end of the regulatory period. Regulatory capital investment in 2012/13, was £787 million, an increase of 16% compared with last year. This increase of over £100 million means that our cumulative investment across the first three years of the 2010-15 regulatory period is now just over £2 billion, reflecting a smoother and more effective investment profile than the previous five-year cycle. We remain on track to deliver the five-year programme within the regulatory allowance of around £3.5 billion and we are reinvesting any capex outperformance to deliver further customer benefits. We expect to deliver around £800 million of capital investment in 2013/14.

Regulatory commitments – Delivering our regulatory commitments is key, not only in terms of service to customers and the environmental impact, but also in respect of shareholder value. UU received a shortfalling revenue penalty of over £80 million at the last price review in 2009. Shortfalling is effectively where a company fails to deliver agreed requirements on time or to specification. We are strongly focused on meeting our regulatory commitments, as we aim to avoid, or at least minimise, any shortfalling revenue penalties at the 2014 price review. We are making good progress and we have delivered all of our capital investment Environment Agency commitments this year.

Business review (continued)

This represents a much improved performance, so far, compared with the 2005-10 regulatory period, and we will continue to treat this as a priority area.

Private sewers – The transfer of private sewers around 18 months ago has gone well and is now embedded within our 'business as usual' activities. The volume of work and the level of expenditure continues to be a little below our expectations. The mix of work continues to relate more to enhancement capex than opex, compared with what we initially expected at the onset. Our operating model has evolved to reflect the revised work scope and volumes. In addition to routine maintenance activity, we are enhancing the quality of the assets where appropriate. This will bring the private sewer infrastructure more in line with our asset standards and will reduce the risk of future problems for our customers.

Key performance indicators:

- **Financing outperformance –** UU has secured over £300 million of financing outperformance across the 2010-15 period, when compared with Ofwat's allowed cost of debt of 3.6% real, based on an average RPI inflation rate of 2.5% per annum. We expect to reinvest around £40 million of our financing outperformance in unfunded private sewers costs.
- **Operating expenditure outperformance** – The business is targeting total operating expenditure outperformance over the 2010-15 period of at least £50 million, or approximately 2%, compared with the regulatory allowance. This is in addition to the base operating expenditure efficiency targets set by Ofwat, which equate to a total of approximately £150 million over the five years. We have now delivered cumulative operating expenditure outperformance of around £50 million in the first three years of the regulatory period and are ahead of schedule.
- **Capital expenditure outperformance –** UU is continuing to deliver significant efficiencies in the area of capital expenditure and expects to meet Ofwat's allowance after adjusting, through the regulatory methodology, for the impact of lower construction output prices. We expect to reinvest around £200 million of capital expenditure outperformance for the benefit of our customers and the environment.

Responsible manner

Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility factors as a strategic decision in its decision making.

Leakage – We were pleased to beat our regulatory leakage target in 2012/13. This reflects our year round operational focus and the implementation of range of initiatives, such as active pressure management. Our leakage performance, alongside the network resilience improvements we are making, are helping us to maintain a robust water supply and demand balance and deliver high levels of reliability for our customers.

Improving rivers and bathing water quality – We have a range of capital projects which are delivering significant customer and environmental benefits. We are undertaking a £100 million+ project in Preston, which is designed to improve river and bathing quality. The project involves building a 3.5 kilometre storm water storage tunnel and the construction of shafts to divert storm water flows, which will be retained in the new storage tunnel. It will reduce the number of spills to the River Ribble from combined sewers and should deliver significant improvements to the Fylde Coast bathing waters and the Ribble Estuary. This is one our largest projects in the 2010-15 period and is now nearing completion. Our Liverpool wastewater treatment works expansion project, at around £200 million, is our largest capital programme in this regulatory cycle. The project will enhance the capacity of the works so it can treat up to 11,000 litres of wastewater per second. The project is progressing well and the higher standards of treatment will continue the rejuvenation of the River Mersey and improve bathing waters across the river on the Wirral. It also provides a significant contribution to the local economy. The extended works are expected to come online in early 2016.

Business review (continued)

Reducing our carbon footprint – We are committed to reducing our carbon footprint and increasing our generation of renewable energy. Our carbon footprint for 2012/13 was 524,264 tonnes of carbon dioxide equivalent, a minor increase of 0.4% compared with last year. This was as a result of an increase in the amount of electricity purchased as we undertook additional pumping activity. Not only did we experience one of the wettest years on record, resulting in significantly more wastewater in our sewers and treatment works, the year began and ended with a prolonged dry spell, so we needed to pump additional volumes of water around our integrated network. We were pleased to retain the Certified Emissions Measurement and Reduction Scheme certification for our carbon accounting methodology. We remain on track to meet our target of a 21% reduction in carbon emissions by 2015 (measured from a 2005/06 baseline). UU has consistently generated around 100 GWh of renewable electricity annually for the past four years, principally from sludge processing. By 2014, we expect to have finished commissioning an innovative £100 million+ recycling and energy plant at one our largest wastewater treatment works at Davyhulme, near Manchester. By treating sludge that is left over at the end of the wastewater treatment process, we can generate enough electricity from biogas to power the Davyhulme site. Sludge is also converted into a valuable agricultural fertiliser.

Environmental performance – This is a high priority for UU and we were pleased to report the lowest number of major pollution incidents of the ten water and wastewater companies, per kilometre of pipe, for 2011/12 (the latest available assessment). Our operational and environmental focus is delivering results and we were pleased to achieve our best performance for many years in the Environment Agency's performance metrics, where we have been rated as an 'above average performer', as detailed in the KPIs section.

Employees – A committed, capable and motivated workforce is central to delivering our vision and we remain strongly focused on high levels of employee development and engagement. We continue to be successful in attracting and retaining people and we were pleased to also extend our apprentice programme during the last year. We currently employ over 80 apprentices and plan to recruit up to a further 40 apprentices each year through to 2015. Alongside this, we are continuing to expand our graduate recruitment scheme, with plans to add more than 20 graduates in 2013/14. This is in addition to over 35 graduates we currently employ. As part of our health and safety improvement programme, we implemented a number of initiatives throughout the year and launched a set of behavioural standards at our main office sites, called the 'Safety Six'. Health and safety will continue to be a significant area of focus for the company, as we strive for continuous improvement.

Communities – We continue to support community partnerships, which help in meeting our company objectives. For example, our partnership with UTV Media takes an online programme into schools to enable them to create a radio advert (part of the national curriculum) linked to one of our key campaigns, such as water efficiency or reservoir safety. With an emphasis on promoting the adverts through social media, this provides an innovative way for our key messages to reach our customers. Education is an integral part of our community approach and our new outreach education partnership started this year and has already reached 139 schools and 4,754 children. Where we cause disruption as part of our major capital works, we invite local community groups to apply for small scale grants to support their work. Last year we contributed to 116 groups in 10 locations across the North West. We also contributed approximately £2 million supporting local communities providing debt advisory services and undertook over 26,000 hours of employee volunteering.

Leading credentials – Our environmental and sustainability performance across a broad front has received external recognition. UU continues to be rated 'World Class' in the Dow Jones Sustainability Index and has retained the highest ranking, 'Platinum Big Tick', in Business in the Community's Corporate Responsibility Index. In addition, UUG holds membership of the FTSE 350 Carbon Disclosure Leadership Index. UUG is one of only four FTSE 100 companies to hold all three awards.

Business review (continued)

Key performance indicators:

- **Leakage** – UU met its economic level of leakage rolling target for the seventh consecutive year in 2012/13, with a performance of 457 megalitres per day versus the regulatory target of 464 megalitres per day. The aim is to meet our regulatory leakage target each year.
- **Environmental performance** – On the Environment Agency's latest assessment, which covers a broad range of operational metrics, UU has been rated as an 'above average performer'. UU has three areas highlighted as 'Green', four as 'Amber', and, importantly, no areas highlighted as 'Red' on the traffic light reporting matrix. This would indicate 3rd position among the ten water and sewerage companies. Although the EA has revised its performance measure, UU was in 7th position on the EA's composite assessment for the previous year, so this represents good progress against the medium-term goal of being a first quartile company on a consistent basis.
- **Corporate responsibility** – UU has a strong focus on corporate responsibility and UUG is the only UK water company to have a 'World Class' rating as measured by the Dow Jones Sustainability Index. UUG aims to retain this 'World Class' rating each year.

Political and regulatory developments

UU is actively involved in political and regulatory developments that relate to the UK water sector and has a proactive programme to engage with all key stakeholders. The retention of investor confidence and customer affordability remain key areas of importance.

Water Bill

We have been actively engaging with the UK Government on its reform agenda. The UK Government published a draft Water Bill in July 2012 and we provided evidence to the Efra Select Committee, as we strive to achieve the optimal outcome for all of our stakeholders. The reform agenda for our sector is also providing new opportunities for us. In addition to the adoption of private sewers and the expanding retail water market for business customers, we are currently exploring opportunities in areas such as water and sludge trading with our regulators. A Water Bill was announced in the Queen's speech on 8 May 2013 and we now await the UK Government's publication of the Bill with interest.

2014 price review

We continue to play an active role and engage positively in regulatory reform. Following a period of constructive dialogue with Ofwat, we were pleased to accept the revised licence modification proposals which were published by the regulator on 21 December 2012. These revised licence proposals focus on the changes required to facilitate the 2014 price review and we are now working closely with the regulator to help shape the forthcoming price review. Ofwat published its 2014 price review methodology consultation in January 2013 and we submitted our response to Ofwat in March. We await Ofwat's methodology document later in the year. We are actively engaging our customers and other stakeholders to help us formulate our business plan for the 2015-20 period. We expect to submit this plan to Ofwat later this year.

Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2013.

Profit and dividends

The results for the year, set out in the profit and loss account on page 41 show that profit for the year after tax was £234.6 million (2012: £120.8 million).

The directors have not recommended a final ordinary dividend (2012: £nil). An interim ordinary dividend of £223.5 million has been declared and paid during the year (2012: £342.0 million).

Principal activity

The principal activity of the company is to provide water and wastewater services in North West of England. The company is a public limited company registered in England and Wales.

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

Political and charitable donations

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

The period 2012/13 saw an increase in stakeholder engagement along a number of policy themes as the industry examined its future development. The company incurred expenditure of £16,211 (2012: £12,328) as part of this process.

Charitable donations by the company in the year amounted to £1,273,253 (2012: £5,345,093). Of this, £1,000,000 (2012: £5,000,000) went to the United Utilities Trust Fund, an independent grant-making trust helping people facing severe financial challenges, whilst the remainder was in support of local charitable causes and those of interest to employees.

Research and development

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

The company is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The company also undertakes specific projects with these and other research and development providers, manufacturers and with universities.

Research and development costs expensed by the company totalled £1.3 million in the year ended 31 March 2013 (2012: £1.6 million). Development costs capitalised by the company amounted to £0.6 million in the year ended 31 March 2013 (2012: £nil).

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 2013.

Directors’ report (continued)

Principal risks and uncertainties

We manage risk through line management supported by our corporate risk management framework which aims for continuous improvement. With an overarching mandate from and commitment by the board, the framework consists of four key areas: governance; approach; guidance; and process.

The application of our framework involves regular review of internal and external risk environments, the assessment of factors that will limit or prevent the achievement of our company objectives and the prioritised implementation of controls and mitigation to manage the exposure and build resilience.

The UUG audit and risk committee regularly reviews the framework’s effectiveness and our compliance with it. There is also twice yearly formal reporting of the most significant risks and profile summary to the board. These activities facilitate the determination of the nature and extent of those risks we are willing to take in pursuing our objectives and accords with good corporate governance practice.

Key developments during the year

Regulatory related risks have featured prominently in our risk profile over the last 12 months with key areas of focus typically being the Government’s market reform agenda and Ofwat’s proposals for future price limits. In addition, two other risks under the regulatory category which were highlighted in the UUG group’s half year accounts continue to exist but are reduced risks for the company:

(i) the risk of potential change in RPI methodology with the potential impact to RCV and income has now reduced due to the Office of National Statistics recommending no change to RPI methodology; and

(ii) the risk of breach of EU legislation relating to intermittent discharge spill criteria at combined sewer overflows (CSO) following the ‘Whitburn’ case.

There is one ongoing piece of material litigation worthy of note but, based on the facts and matters currently known to us and the provision carried in the company’s balance sheet, the directors are of the opinion that the possibility of the disputes having a material adverse effect on the company’s financial position is remote.

Government market reform agenda

The Government’s White Paper (Water for Life) highlighted key policy priorities for the water industry. A draft Water Bill was published on 10 July 2012 and incorporates changes to legislation that would be required to enable many of the changes set out in the White Paper. These include measures to introduce competition and the removal of barriers to entry. The scale and impact of retail and upstream competition will depend on the mechanisms set out in an expected new draft Bill and what ultimately becomes legislation. As a result and until this publication, there is significant uncertainty about the potential impacts; however, these could include: increased costs, reduced income and reduced confidence in the RCV mechanism leading to a rise in future costs of borrowing.

Control/Mitigation

We have been fully engaged, as has the whole industry, in all Government and Ofwat consultations in relation to competition and industry reform.

We are also making determined efforts to retain customers in area, win out of area customers and prepare for a more competitive environment and the potential opportunities that this may bring.

Future price limits and the price control review 2014

In May 2012, Ofwat published a document setting out the key principles it expects to follow in future price reviews. Ofwat then undertook a lengthy and ongoing consultation over its proposals for reform of the methodology and approach for setting prices from 2015, the most recent of which was the draft methodology issued on 28 January 2013.

Directors' report (continued)

The principal decision to date is that Ofwat will set two binding retail price controls (one for household and one for non-household) and two binding wholesale controls (one for water and one for wastewater). Other proposals include: household/non-contestable retail cost recovery based on an average cost to serve; the introduction of a new 'Totex' menu approach to assessing cost assumptions; the setting of a lower cost of capital and the potential for different approaches to sharing the benefits of outperformance between shareholders and customers. These areas contribute to a wider risk of failing to achieve a successful Final Determination following Ofwat's price control review which could result in loss of income and profit, significant cost recovery shortfall, a reduction in allowed expenditure (both capital and operating expenditure) and the ability to outperform. There will also be additional costs for preparing for and administrating separate price controls for retail and wholesale.

Control/Mitigation

We have raised and explained our concerns with Ofwat and, where appropriate, made alternative proposals as part of the consultation process. We continue to make strong representation to Ofwat on these issues, particularly in relation to the 'cost to serve' proposals.

More generally, a successful price control review (meeting the needs of customers and stakeholders) is being targeted through a dedicated 2014 price review programme team whose activities are focused on appropriate deliverables and stakeholder engagement. The final price review methodology proposals are due to be issued later this summer.

Failure to comply with applicable law or regulations

We are subject to various laws and regulations associated with water and wastewater service, health and safety, the environment, property/land management and the general running of a company. If we fail to comply, or become involved in third party proceedings including civil actions by third parties for infringement of rights or nuisance, we could face a range of outcomes. These include financial penalties (of up to 10 per cent of relevant regulated turnover), the imposition of an enforcement order requiring additional capital/operating expenditure, or compensation following litigation. In more extreme circumstances, impacts could ultimately include the revocation of our licence to operate or the appointment of a special administrator.

Control/Mitigation

We have robust processes in place to identify risks to our compliance with legal and regulatory obligations. This includes the continual monitoring of legislative and regulatory developments, the training of employees in new developments and the participation in consultations to influence their outcome, either directly or through industry trade associations for wider issues. Funding for any additional compliance costs in our regulated business is sought as part of the price determination process. We also robustly defend litigation where appropriate and seek to minimise our exposure by establishing a provision and seeking recovery wherever possible.

Material litigation

In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water PLC (UUW) in respect of UUW's discharges of water and treated effluent into the canal. UUW filed a Defence and Counterclaim in support of its believed entitlement to make discharges into the canal without charge and await MSCC's response. Although UUW won a 'summary judgment' application against MSCC in January on a significant element of the claim, MSCC subsequently appealed to the Court of Appeal who dismissed UUW's summary judgment. UUW was then granted permission to appeal to the Supreme Court, the hearing to be in the next 6 to 12 months.

Directors' report (continued)

Control/Mitigation

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

Pension deficit risk

The company participates in a number of pension arrangements (see note 21 for further details). Estimates of the amount and timing of future funding for these schemes are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the scheme assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may require the company to make additional contributions to these pension schemes which, to the extent they are not recoverable under the regulatory price determination process, could materially adversely affect the company's financial position.

Control/Mitigation

In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit shown in UUW's final business plan over a 10-year period (subject to reaffirmation at the next price review) and allowed for half of this deficit when setting its overall price controls for the 2010–15 period. In response to the size of our ongoing pension risks and pension costs we introduced a series of changes for employees in defined benefit (DB) schemes. These changes, which came into force on 31 March 2010, should result in reduced costs and risks, including deficit, associated with DB liabilities in the future. In conjunction with the trustees we continue to monitor and to look to reduce the investment strategy risks for the pension schemes, including our exposure to investment risks. We are also engaged with Ofwat on the appropriate allowance for pension deficits for the next price review period.

Counterparty risk

The company participates in treasury activities including the depositing of cash and holding of derivatives and foreign exchange instruments. Although we do not consider there to be an imminent exposure, a potential loss of deposits, financial assets or hedge due to bank failure, error or delay in receiving funds from a bank or sequestration could impact cash flow, the ability to meet debt obligations, credit rating and cost of borrowing.

Control/Mitigation

Risks from treasury activities are covered by policies set by the treasury committee with operational management the responsibility of the treasury department.

These include establishing a total credit limit for each counterparty which comprises a counterparty credit limit and an additional settlement limit to cover intra-day gross settlement cash flows. In addition, potential derivative exposure limits are also established to take account of potential future exposures. These limits are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty.

In respect of cash, short-term deposits and derivative financial instruments, the company does not have a material exposure to any financial instruments based within the Eurozone with the exception of Germany and has not experienced any credit issues in the financial year.

Directors’ report (continued)

Customer service risk

Failure to deliver good customer service can be caused by failures in supply and quality requirements and also the effectiveness of communication and response. The Service Incentive Mechanism (SIM), introduced by Ofwat for the 2010–15 period, replacing the Overall Performance Assessment (OPA), compares companies’ performance in terms of the number of ‘unwanted’ contacts received from customers and how well a company then deals with those contacts. Depending on UUW’s relative performance under SIM it could receive a revenue penalty (up to 1 per cent of turnover in 2010–15) or reward (up to 0.5 per cent of turnover in 2010–15) when price limits are next reset in 2014.

Control/Mitigation

The company has been monitoring and measuring customer satisfaction for a number of years and results have been improving consistently. We have already improved our SIM score [as detailed in our KPIs]. We have an overall customer experience programme covering a range of initiatives to improve customer service, responding to our customers’ requirements and focusing on people, processes and systems. The company’s focus is on ensuring right first time service delivery to our customers, thus avoiding the need for ‘unwanted’ contacts and reducing associated operating costs. Where ‘unwanted’ contacts do arise, there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score. These actions are intended to ensure that the company’s performance under SIM is optimised thereby mitigating the risk of a penalty at the next price review.

Bad debt risk

The service we provide is predominantly in the North West of England where the level of socio-economic deprivation is much higher than in any other region, leading, amongst other things, to an increased risk of bad debt. The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment.

Control/Mitigation

Bad debt risk is managed in-house by the customer collections department whose approach includes the adoption of best practice collection techniques and segmentation of customers based on their credit risk profile.

Operational service risk

The company controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. Physical, environmental, technological, or human factors, either within or outside the company’s control, could result in impacts ranging from a decline in performance to interruptions and environmental impact. Ofwat could make financial adjustments at the next price review if corrective actions do not restore service to the required reference levels for each of their serviceability measures and could go on to force additional operating or capital expenditure if performance were to continue to decline. Additionally, depending on the nature and extent of an operational service incident, we could be fined for breaches of statutory obligations, be held liable to third parties or be required to provide an alternative water supply of equivalent quality, at additional cost.

Control/Mitigation

Operational processes combined with the capital investment programme are targeted to maintain stable serviceability of the company’s water and wastewater assets and to minimise the chance of significant operational events occurring. The various indicators of performance are closely and routinely monitored by management.

There are also governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Where adverse trends in performance or asset integrity develop, corrective action is identified and taken.

Directors' report (continued)

The sustainability and resilience of our water supply is also managed through regional aqueduct networks allowing flexibility and we operate emergency plans, incident management and disaster recovery processes for the response and/or recovery of operational service failures. Insurance cover is also in place against loss and liabilities associated with significant risks.

Capital delivery risk

Our core business requires significant capital expenditure, particularly in relation to new and replacement plant and machinery for water and wastewater networks and treatment facilities.

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

Control/Mitigation

Capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for outperformance and any necessary corrective actions. Executive directors are incentivised, as part of their bonusable measures, on time, cost and quality of delivery of our capital investment programme.

Secure supply of safe clean drinking water risk

A secure and reliable supply of safe, clean drinking water is critical for our way of life. There are several events, either within or outside our control, that could put at risk this key requirement. These include inadequate supply and demand prediction, leakage performance issues, operational or asset failures, changes to abstraction licences, low rainfall or malicious acts. Depending on the nature and extent of these circumstances, the impact to the company may include: failure to meet the security of supply index or quality standards with associated regulatory penalties, increased frequency of hosepipe bans and drought permits and additional operational activity and cost. In extreme and remote circumstances, impacts may include unavoidable water resource shortfalls or an impact on public health.

Control/Mitigation

Our management of water catchments is designed to ensure reliable yields of good quality raw water. In addition, our Water Resources Management Plan compares future demand with availability, analyses historic droughts and climate change data and seeks to inform the delivery of supply enhancements and demand reductions. It covers leakage reduction programmes, enhanced water efficiency and network enhancements. We also maintain a drought management plan which includes processes, supporting communication plans and options for reserve supplies.

Our treatment of water is based on quality assurance procedures and water supply is through an increasingly integrated network. Security measures are in place to protect these assets and our capital investment programme targets improvements to water quality and supply. This is all supported by testing regimes through our scientific services department and drinking water safety plans to ensure that risks to drinking water quality are identified and managed across our entire network.

We also operate emergency and incident management processes should there ever be a need for alternative water supply of equivalent quality.

Significant and catastrophic events

Our core activity involves the building, control and operation of water and wastewater networks and the maintenance of the associated assets with the objective of providing a continuous service.

Directors' report (continued)

This includes major construction work and operations above and below ground and includes the use of vehicles, equipment and chemicals subject to a variety of physical and environmental factors/conditions. In exceptional and remote circumstances, such as the failure of an asset, an element of a network or supporting systems, plant or machinery, the impact could be significantly greater than operational service failures set out in other risks in this section. These could range from environmental impact, economic and social disruption to loss of life. Such consequences may arise due to a number of circumstances either within or outside our control e.g. human error, an individual's malicious intervention or unavoidable resource shortfalls.

Whilst we seek to ensure that we have appropriate processes and preventative controls in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of our customers, regulators, government and the wider stakeholder community. We could be fined for breaches of statutory obligations or be held liable to third parties or be required to provide an alternative water supply of equivalent quality, which could increase our costs.

Control/Mitigation

We have developed and continue to focus on a strong safety and health culture throughout the organisation and seek to achieve the highest safety standards not simply to comply with legislation but to contribute to our overall business performance while protecting employees, contractors and the public from harm. In support of this, the business operates a Health and Safety Management System (HSMS) which sets out minimum expectations and requirements including monitoring the occupational health of individuals when appropriate.

We operate long-standing, well tested and appropriately resourced incident response and escalation procedures. Our processes continue to be refined alongside related risk management and business continuity procedures which complement the governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. Disaster recovery processes also exist for the recovery of IT applications, all recognising that possible events can have varying causes, impacts and likelihoods. The sustainability and resilience of our water supply is also managed through regional aqueduct networks which are enhanced by the West East Link pipeline. We also maintain insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost-effectively.

The licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers (by way of interim determination) in the event of a catastrophic incident.

Going concern

The directors' considerations in preparing these financial statements on a going concern basis are set out in the corporate governance report.

Directors

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

Non-executive directors
Dr CED Bell
P Heiden
DH Jones (resigned 27 July 2012)
Dr JDG McAdam
NR Salmon
SV Weller
BM May (appointed 1 September 2012)

Directors' report (continued)

Executive directors
JR Houlden
SL Mogford
SR Fraser (appointed 1 April 2013)

Company secretary
SR Gardiner

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

Directors' indemnities and insurance

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

Employment policies

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

Supplier payment policy and practice

Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance. As at 31 March 2013, the average credit period taken for trade purchases was 49 days (2012: 38 days).

Financial instruments

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

Tangible assets

The company 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 company's regulated business. The nature of these assets, which are primarily moorland areas and which could not be sold by the company, means that it is impractical to obtain meaningful market values for the land. Other land owned by the company, the majority of which relates to operational sites, does not have a market value materially different from historic cost.

Regulation

As required by paragraph 3.1 of Condition K of the Instrument of Appointment granted by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Industry Act 1991 ('the Licence'), the directors state that they are satisfied that as at 31 March 2013, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of UUW, the company would have had available to it sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company so that the purpose of the order could have been achieved.

Directors' report (continued)

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

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

Regulatory accounts measures

	2013	2012
Appointed business only:	£m	£m
Operating profit per historical cost profit and loss account	635.9	589.8
Exceptional operating costs *	2.6	22.8
Underlying operating profit	638.5	612.6

Atypical operating expenditure items

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

	2013	2012
	£m	£m
Recognition of contractual liabilities *	-	20.2
Severance related restructuring costs *	2.6	2.6
Legal provisions	-	2.0
Costs to remove concessionary supplies at Oswestry	-	1.8
Network incidents	-	0.8
	2.6	27.4

* see note 4 of the statutory financial statements

Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation

The annual infrastructure renewals charge is based on infrastructure renewals spend for 2012/13, the Company Business Plan for Asset Management Plan (AMP) 5 and the Final Business Plan projections for AMP 6 and AMP 7 covering the period 2010 to 2025. The charge for the year ended 31 March 2013 is £149.6 million (2012: £141.6 million).

The current cost depreciation charge (net of deferred credits) for the year is £421.2 million (2012: £382.3 million). This increase of £38.9 million is mainly due to the impact of higher accelerated depreciation in the year ended 31 March 2013, the RPI uplift and the increased depreciation from assets commissioned in in the year, offset by a depreciation on assets which became fully depreciated in the year.

Directors' report (continued)

Disclosure of information to the auditor

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

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

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

Auditor

Our auditor, KPMG, has informed us that for administrative reasons and to instigate the orderly wind down of business, they wish to formally change the entity which conducts the company's audit from KPMG Audit Plc to KPMG LLP. KPMG Audit Plc has indicated that it will not stand for reappointment at our 2013 AGM, however KPMG LLP will seek election at this meeting. Our board has decided to recommend KPMG LLP to be appointed as external auditor to the company at the AGM and an authority for the directors to set the remuneration of the auditor will also be sought.

Approved by the board and signed on its behalf by:

JR Houlden
Director
4 June 2013

Statement of directors' responsibilities in respect of the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law).

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

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

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

Corporate governance report

United Utilities aspires to the highest standards of board leadership, transparency and governance, both at the regulated company board (United Utilities Water PLC) and also in the listed holding company (United Utilities Group PLC).

The UK Corporate Governance Code

The Licence of United Utilities Water PLC ('UUW', the 'company' as the context requires) agreed with its regulator, Ofwat (the Water Services Regulation Authority), that the company should 'have regard to' the UK Corporate Governance Code ('the Code') the version, applicable to the 31 March 2013 year end, was published by the Financial Reporting Council in June 2010. The company, in agreement with Ofwat, operates a structure that allows directors to be members of the boards of both the company and its ultimate holding company United Utilities Group PLC ('UUG') in order to increase the efficiency and effectiveness of the corporate governance structure. These arrangements have been in place from the end of March 2011 and were in place throughout the year ended 31 March 2013.

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

The board also considered the Code provisions of Section C ('Accountability'), Section D ('Remuneration') and Section E ('Relations with Shareholders'). After due consideration, it was concluded that none of these sections were appropriate for UUW. The reasons for the non-application set out on page 39 of Sections C, D and E have been notified to Ofwat.

The board of directors

The directors who served during the year are set out on page 29. Eight board meetings are scheduled each financial year and the board will meet more or less frequently as required. During the financial year ended 31 March 2013, eight meetings were held (financial year ended 31 March 2012: eight).

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

Board	
Dr C Bell	8 (8)
P Heiden	8 (8)
R Houlden	8 (8)
D Jones	4 (4)
B May	4 (4)
Dr J McAdam	8 (8)
S Mogford	8 (8)
N Salmon	8 (8)
S Weller	8 (8)

Corporate governance report (continued)

Notes:

(1) David Jones retired from the board on 27 July 2012.

(2) Brian May was appointed to the board on 1 September 2012.

(3) Steven Fraser was appointed to the board on 1 April 2013.

Summary of approach to governance

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

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

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

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

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

The treasury arrangements introduced during the year ended 31 March 2012 have continued throughout the year ended 31 March 2013.

Chairman and chief executive officer

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

Board balance and independence

During the year (apart from between 27 July 2012 and 1 September 2012 when David Jones retired from the board and Brian May was appointed to the board), five independent non-executive directors served on the UUW board (in addition to the non-executive chairman and the two executive directors).

Corporate governance report (continued)

This exceeded the Company's Licence obligation of three independent non-executive directors determined by the board to be independent in accordance with the Code. From 1 April 2013, the number of executive directors increased to three following the appointment of Steven Fraser to the board. The directors have a wide and diverse range of business and other experience and expertise. As stated previously, all the directors of UUW are also directors of UUG (with the exception of Steven Fraser who is a director of UUW only). As agreed with Ofwat, the non-executive directors will not be appointed to the board of any other group company. On 1 April 2013, Steven Fraser was appointed to the board as an additional executive director. Steven Fraser was only appointed to the United Utilities Water PLC board and not to the board of United Utilities Group PLC. Steven Fraser has previously served on the board of the company between 15 July 2009 and 30 March 2011.

Senior independent director

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

Conflicts of interest

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

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

Re-appointment of directors

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

Information, support and advice

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

Corporate governance report (continued)

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

Induction and training

On joining the group directors receive a tailored induction programme, including an induction pack, time spent with other directors, the company secretary and the executive team. During the year, Sara Weller's induction continued and an induction programme for Brian May was planned and commenced. (It is not intended to conduct an induction programme for Steven Fraser as he has previously served on the board of the company and has held a senior management role in the company for a number of years.) Directors are provided with details of seminars and training courses relevant to their role and are encouraged to attend those that meet their development needs. During the year, the board's understanding of the regulatory environment in which the Company operates was enhanced via additional briefings on the licence negotiations with Ofwat. The board also received briefings on the preparation for the 2014 Price Review, retail competition, the treatment of customer debt as well as regular briefings on regulatory updates.

Additionally, in July 2012, the board also had the opportunity to visit Dove Stone reservoir prior to the board meeting. During this visit, the board had the opportunity to look at our Sustainable Catchment Management Programme (SCaMP) in action. They also met with Mike Clarke, the chief executive of the RSPB with whom UUW has a number of partnerships around its catchments. In April 2013, the board also held its meeting at Liverpool Wastewater Treatment Works and combined this with a tour of the site.

Performance evaluation

During the year the UUG board undertook an internally facilitated evaluation of its board, committees and directors which aimed to build upon the externally facilitated evaluation conducted during the previous year. Given that there is a high degree of overlap (and common board membership) between the UUW and UUG boards, the board evaluation posed questions that were relevant to both boards and the results and recommendations were also shared with both boards. (For further details please see the corporate governance report within the UUG 2013 annual report).

Internal controls and risk management

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

Risks impacting our business due to regulatory changes have dominated our risk review agenda at board meetings. The principal risks and uncertainties to the business are explained on pages 24 to 29.

Corporate governance report (continued)

We continue to work with all key parties to represent the best interests of our stakeholders, and where we can identify actions to mitigate the adverse consequences of these potential regulatory changes we are working hard to address these changes to our business in a pro-active manner.

Going concern

As part of its review of the financial report and accounts, the board considered whether the company had adequate financial resources to continue trading as a ‘going concern’. FRC guidance requires that in order to be considered to be a ‘going concern’ the company should have adequate financial resources for at least 12 months from the date of approval of the financial statements.

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 policy in preparing the financial statements. This conclusion is based upon, amongst other matters, a review of the company’s financial projections together with a review of the cash and committed borrowing facilities available to the company as well as consideration of the company’s capital adequacy. In addition, the directors considered, amongst other matters, the regulator’s legal duty to ensure that United Utilities Water PLC is able to finance its activities. The directors also took into account potential contingent liabilities and other risk factors as interpreted by the guidance given in ‘Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009’.

Auditor independence

The company adheres to the UUG policies on auditor independence which are described in the UUG accounts (available from the address given in note 30). In accordance with Financial Reporting Council’s guidance, fees for permitted non-audit services such as tax advisory services are pre-approved by the UUG audit and risk committee and do not require further approval so long as the cumulative value of these services is less than 30 per cent of the group annual audit and regulatory reporting fee (£320,000 for 31 March 2013); fees for permitted non-audit services in excess of this 30 per cent level will need to be specifically approved by the UUG audit and risk committee. There are a range of services which KPMG are prohibited from providing to the company such as: business process improvement advisory services; employee benefit plan advisory services; operational consulting; internal audit services; cash management and treasury services; and strategic planning support.

UUW changed its auditor from Deloitte LLP to KPMG Audit Plc during the year ended 31 March 2012. KPMG has informed us that for administrative reasons and to instigate the orderly winding up of business, they wish to formally change the KPMG entity which conducts the United Utilities Water PLC audit from KPMG Audit Plc to KPMG LLP. KPMG Audit Plc have indicated that they do not wish to stand for reappointment at the forthcoming 2013 annual general meeting at which point KPMG LLP will take over. The appropriate resolution to approve the appointment of KPMG LLP as auditor to the company will be put to shareholder at the forthcoming annual general meeting. There are no contractual obligations restricting the company’s choice of external auditor.

Licence Obligations

The board receives reports about the performance of the company, and annually approves the Risk and Compliance Statement (the ‘statement’). The statement sets out how the board pays particular regard to and shows awareness of the obligations of UUW’s Licence and how these Licence obligations are met.

Corporate governance report (continued)

Departures from the Code as notified to Ofwat

Section C of the Code – Accountability

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

Section D of the Code – Remuneration

The board concluded that having its own remuneration committee was unnecessary and would not improve governance.

The company remunerates its executive directors and senior management subject to the confines of UUG's remuneration policy (for further details please see the remuneration report within the UUG 2013 annual report). In accordance with their letters of appointment the non-executive directors do not receive any additional remuneration from the company for their services to the UUW board over and above that paid to them for their services to the UUG board.

Section E of the Code – Relations with Shareholders

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

Independent auditor's report

to the members of United Utilities Water PLC

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2013 set out on pages 41 to 78. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 33, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

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

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

John Luke (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc
Statutory Auditor
St James' Square
Manchester
M2 6DS
4 June 2013

Profit and loss account

For the year ended 31 March 2013

	Note	2013 £m	2012 £m
Turnover		1,604.7	1,534.9
Total net operating expenses	3	(969.4)	(938.2)
Operating profit before exceptional costs		637.9	619.5
Exceptional operating costs	4	(2.6)	(22.8)
Operating profit		635.3	596.7
Net interest payable and similar charges	7	(323.9)	(353.0)
Profit on ordinary activities before taxation		311.4	243.7
Taxation charge on profit on ordinary activities	8	(76.8)	(122.9)
Profit after taxation	23	234.6	120.8

All of the results shown above relate to continuing operations.

Statement of total recognised gains and losses

For the year ended 31 March 2013

	2013 £m	2012 £m
Profit after taxation	234.6	120.8
Actuarial gains on defined benefit pension schemes (see note 21)	33.0	4.3
Taxation on items taken directly to equity (see note 8c)	(7.7)	(1.9)
Total recognised gains and losses for the year	259.9	123.2

Reconciliation of movements in shareholders' funds

For the year ended 31 March 2013

	2013 £m	2012 £m
Profit after taxation	234.6	120.8
Dividends paid on equity shares (see note 9)	(223.5)	(342.0)
Actuarial gains on defined benefit pension schemes (see note 21)	33.0	4.3
Taxation on items taken directly to equity (see note 8c)	(7.7)	(1.9)
Net increase/(decrease) in shareholders' funds	36.4	(218.8)
Opening shareholders' funds	2,017.3	2,236.1
Closing shareholders' funds	2,053.7	2,017.3

Balance sheet

At 31 March 2013

	Note	2013 £m	2012 £m
Fixed assets			
Intangible assets	10	0.6	-
Tangible assets	11	8,650.7	8,324.2
Investments	12	0.2	0.2
		8,651.5	8,324.4
Current assets			
Stocks		5.6	5.0
Debtors: amounts falling due within one year	13a	420.4	378.8
Debtors: amounts falling due after more than one year	13b	505.8	435.5
		931.8	819.3
Creditors: amounts falling due within one year			
Trade and other creditors	14a	(437.4)	(449.1)
Borrowings	14b	(308.4)	(200.5)
		(745.8)	(649.6)
Net current assets		186.0	169.7
Total assets less current liabilities		8,837.5	8,494.1
Creditors: amounts falling due after more than one year			
Trade and other creditors	15a	(289.0)	(252.2)
Borrowings	15b	(6,119.9)	(5,788.0)
		(6,408.9)	(6,040.2)
Provisions for liabilities	17	(404.2)	(405.5)
Net assets excluding pension surplus/(liability)		2,024.4	2,048.4
Pension surplus/(liability)	21	29.3	(31.1)
Net assets including pension surplus/(liability)		2,053.7	2,017.3
Capital and reserves			
Called up share capital	22, 23	1,025.3	1,025.3
Share premium account	22, 23	647.8	647.8
Profit and loss account	23	380.6	344.2
Shareholders' funds		2,053.7	2,017.3

The financial statements of United Utilities Water PLC, registered number 2366678, were approved by the board of directors on 4 June 2013 and signed on its behalf by:

JR Houlden
Director

Cash flow statement

For the year ended 31 March 2013

	2013 £m	2012 £m
Net cash inflow from operating activities (see note 25)	987.2	895.1
Returns on investments and servicing of finance		
Interest received	-	0.1
Interest paid	(170.2)	(167.0)
Non-equity dividends paid	(13.7)	(4.6)
Net cash outflow from returns on investments and servicing of finance	(183.9)	(171.5)
Taxation	(84.8)	(13.1)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(783.3)	(692.0)
Purchase of intangible assets	(0.6)	-
Grants and contributions received	24.0	31.3
Proceeds from sale of tangible fixed assets	1.6	1.7
Net cash outflow for capital expenditure and financial investment	(758.3)	(659.0)
Equity dividends paid (see note 9)	(223.5)	(342.0)
Cash outflow before management of liquid resources and financing	(263.3)	(290.5)
Management of liquid resources		
Decrease in short-term deposits	-	1.6
Financing (see note 27)	168.0	287.5
Decrease in cash and overdraft in the year	(95.3)	(1.4)

Notes to the financial statements

1. Accounting policies

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

Basis of preparation of financial statements

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

Going concern

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

Related party transactions

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

Turnover

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

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

Research and development

Research and development expenditure is written off as incurred, except that when development expenditure incurred on an individual project is carried forward when its future recoverability can be reasonably be regarded as assured. Any expenditure carried forward is amortised in line with the expected future income from the related projects.

Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including land and buildings and overground plant and machinery). Employee and other related costs that are directly attributable to implementing the capital schemes of the company are capitalised. Finance costs incurred in respect of the construction of tangible fixed assets are expensed as incurred.

Infrastructure assets

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

Notes to the financial statements (continued)

1. Accounting policies (continued)

Tangible fixed assets (continued)

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

Other assets

Additions are included at cost. Freehold land is not depreciated nor are assets in the course of construction until commissioned. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful economic lives based on management's judgement and experience, which are principally as follows:

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

Depreciation on these assets commences in the month following commissioning.

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

Grants and contributions

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

The directors are of the opinion that these assets do not have determinable finite useful economic lives and the capital contributions would therefore remain in the balance sheet in perpetuity. The treatment otherwise required by the Accounting Regulations would not present a true and fair view of the company's effective investment in infrastructure assets. The financial effect of this accounting policy is set out in note 11.

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

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

Leased assets
Leases are classified according to the substance of the transaction. Operating leases are leases that do not transfer substantially all the risks and rewards of ownership to the lessee.

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

Stocks

Stocks are stated at the lower of cost and net realisable value.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Pensions

The company participates in the following pension schemes sponsored by the United Utilities group of companies: the United Utilities Pension Scheme (UUPS) and the United Utilities PLC Group of the Electricity Supply Pension Scheme (ESPS). UUPS has both a funded defined benefit section and a defined contribution section. The defined contribution section constitutes around 2 per cent of the total asset value of UUPS. ESPS is a funded defined benefit scheme. Both defined benefit schemes are closed to new employees.

Under FRS 17 'Retirement benefits', the current service cost is calculated using the projected unit credit method and will therefore normally increase as the members of the scheme approach retirement. The assets of the pension schemes are held in trust funds that are independent of the company's finances.

Actuarial valuations of the defined benefit schemes are performed at intervals of not more than three years and the rates of contribution payable are determined on agreement between the company and the Trustees on the advice of the actuary for each scheme having regard to the results of these actuarial valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates. The last actuarial valuations were carried out as at 31 March 2010. An actuarial valuation as at 31 March 2013 is being undertaken and is expected to be completed in the 2013/14 financial year.

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

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

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

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

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

Financial instruments

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

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

Financial investments
Investments (other than short-term deposits) are initially measured at fair value, including transaction costs. Investments classified as available-for-sale are measured at subsequent reporting dates at fair value.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Financial instruments (continued)

Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

Trade debtors
Trade debtors are initially measured at fair value, and are subsequently measured at amortised cost, less any impairment for irrecoverable amounts. Estimated irrecoverable amounts are based on historical experience of the debtor balance.

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

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

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

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

Borrowings
The company's default treatment is that bonds, loans and overdrafts are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently measured at amortised cost applying the effective interest method. The difference between the net cash proceeds received at inception and the principal cash flows due at maturity is accrued over the term of the borrowing.

The default treatment of measuring at amortised cost, whilst associated hedging derivatives are recognised at fair value, presents an accounting measurement mismatch that has the potential to introduce considerable volatility to both the income statement and the statement of financial position. Therefore, where feasible, the company takes advantage of the provisions under FRS 26 'Financial Instruments: Recognition and Measurement' to fair value its borrowing instruments to reduce this volatility and better represent the economic hedges that exist between the company's borrowings and associated derivative contracts.

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

Borrowings designated within a fair value hedge relationship
Where designated, bonds and loans are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently adjusted for any change in fair value attributable to the risk being hedged at each reporting date, with the change being charged or credited to net interest payable in the profit and loss account.

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

Notes to the financial statements (continued)

1. Accounting policies (continued)

Financial instruments (continued)

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

Derivative financial instruments
Derivative financial instruments are measured at fair value at each reporting date with changes in fair value being charged or credited to net interest payable in the profit and loss account.

The company enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note 20).

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

The valuation of debt designated in a fair value hedge relationship is calculated based on the risk being hedged as prescribed by FRS 26 ‘Financial Instruments: Recognition and Measurement’. The company’s policy is to hedge its exposure changes in the applicable underlying interest rate and it is this portion of the cash flows that is included in the valuation model (excluding any applicable company credit risk spread).

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

Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Expenditure that relates to an existing condition caused by past operations and does not contribute to current or future earnings is expensed.

Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is recognised in respect of timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred. Timing differences are differences between the company’s taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Taxation (continued)

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

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

2. Segmental information

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

3. Total net operating expenses

Operating profit is stated after charging/(crediting):

	2013 £m	2012 £m
Employee costs (including directors)		
Wages and salaries	201.9	188.6
Social security costs	16.0	15.8
Post-employment benefits (see below)	20.9	16.4
	238.8	220.8
Less: charged to regulatory capital schemes	(114.8)	(92.6)
Charged to profit and loss account	124.0	128.2

Options over shares of the ultimate parent undertaking, United Utilities Group PLC, have been granted to employees of the company under various schemes. Details of the terms and conditions of each share option scheme are given in the United Utilities Group PLC Annual Report 2013. Included within wages and salaries is an expense of £1.9m (2012: £1.2m) relating to a recharge of share-based payment costs from the ultimate parent undertaking.

	2013 £m	2012 £m
Depreciation		
Non-infrastructure depreciation	298.6	269.4
Infrastructure depreciation (see note 11)	154.7	139.1
Total depreciation (see note 11)	453.3	408.5

Notes to the financial statements (continued)

3. Total net operating expenses (continued)

	2013 £m	2012 £m
Other operating expenses/(income)		
Hired and contracted services	110.1	126.4
Materials	54.4	54.9
Power	60.1	48.5
Property rates	80.2	78.1
Charge for bad and doubtful debts	35.5	33.5
Loss on disposal of tangible fixed assets	9.8	8.1
Other operating expenses	42.2	31.5
Auditor's remuneration – audit of the company's financial statements	0.1	0.1
Auditor's remuneration – regulatory audit services	0.1	0.1
Auditor's remuneration – non-audit services	0.1	-
Amortisation of grants and contributions (see note 16)	(6.7)	(6.5)
Rents receivable	(1.3)	(1.4)
Research expenditure	1.3	1.6
Operating leases:		
- plant and machinery	0.9	0.8
- land and buildings	2.7	3.0
	389.5	378.7
Net operating expenses before exceptional costs	966.8	915.4
Exceptional operating costs (see note 4)	2.6	22.8
Total net operating expenses	969.4	938.2

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

	2013 £m	2012 £m
Defined benefit expense (see note 21)	15.4	12.2
Defined contribution pension costs (see note 21)	5.5	4.2
	20.9	16.4

Included in the 2012/13 defined contribution pension costs of £5.5million (2011/12: £4.2 million) are £1.2 million (2011/12: £0.9 million) of cash recharges from United Utilities PLC relating to services provided to the company by employees of United Utilities PLC.

Notes to the financial statements (continued)

4. Exceptional operating costs

	2013 £m	2012 £m
Recognition of contractual liabilities *	-	20.2
Restructuring costs	2.6	2.6
	2.6	22.8

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

5. Directors' emoluments

	2013 £m	2012 £m
Aggregate emoluments in respect of qualifying services	4.0	3.2

	2013 Number	2012 Number
Number of directors who received shares in respect of qualifying services	2	2
Number of directors who exercised share options	-	-
Number of directors accruing benefits under defined benefit schemes	-	-

	2013 £m	2012 £m
In respect of the highest paid director		
Aggregate emoluments	2.0	1.6

There were no directors with incentive plans which vested during the year ended 31 March 2013 (2012: none). Details of the employee Sharesave scheme and the executive share option scheme operated by United Utilities Group PLC are given in that company's financial statements.

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

6. Employees

	Average 2013	Average 2012
Number of persons employed during the year	4,938	4,558

The 2013 employee costs of £238.8 million (2012: £220.8 million) disclosed in note 3 include the employee costs relating to the persons employed during the year noted above in addition to amounts recharged to the company of £22.7 million (2012: £28.7 million) in relation to services provided to UUW by employees of United Utilities PLC. The average number of employees of United Utilities PLC providing services to the company during the year was 358 (2012: 495).

Notes to the financial statements (continued)

7. Net interest payable and similar charges

	2013 £m	2012 £m
Interest payable and similar charges		
On bank loans, overdraft and other loans	242.4	255.3
On borrowings from parent and fellow subsidiary undertakings	4.7	4.2
Interest payable before preference share dividends and fair value adjustments	247.1	259.5
Preference share dividends (see notes 9 and 14b)	9.1	9.1
	256.2	268.6
Fair value losses/(gains) on debt and derivative instruments [(1)]		
Fair value hedge relationships		
- Borrowings	73.9	175.9
- Designated swaps	(72.1)	(172.2)
	1.8	3.7
Financial instruments at fair value through profit or loss		
- Borrowings designated at fair value through profit or loss [(2)]	17.6	19.1
- Held for trading derivatives – economic hedge	(13.5)	(47.9)
	4.1	(28.8)
Held for trading derivatives – 2010-2015 regulatory hedge	(12.6)	74.0
Held for trading derivatives – regulatory hedges > 2015	52.6	18.2
Held for trading derivatives – electricity hedges	1.5	4.6
Net payments on swaps and debt under fair value option	12.2	11.4
Held for trading derivatives – other [(3)]	4.0	(2.0)
Other	(3.1)	0.3
	54.6	106.5
Net fair value losses [(4)]	60.5	81.4
Net pension interest expense (see note 21)	7.3	3.2
Total interest payable and other similar charges	324.0	353.2
Interest income		
External interest receivable and similar income	(0.1)	(0.2)
Total interest income	(0.1)	(0.2)
Net interest payable and similar charges	323.9	353.0

[(1)] Fair value losses on debt and derivative instruments includes foreign exchange gains of £4.6 million (2012: £23.6 million), excluding those on instruments measured at fair value through profit or loss. These gains are largely offset by fair value losses on derivatives.

[(2)] Includes £1.5 million of losses (2012: £21.3 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 other economic hedge derivatives relating to debt held at amortised cost.

[(4)] Includes £12.2 million expense (2012: £12.1 million) due to interest on swaps and debt under fair value option.

Notes to the financial statements (continued)

8. Taxation charge on profit on ordinary activities

(a) Analysis of charge in the year

	2013 £m	2012 £m
Current taxation:		
UK corporation tax at 24% (2012: 26%)	84.0	62.7
Adjustment in respect of prior years	(4.1)	(11.6)
Total current taxation charge	79.9	51.1
Deferred taxation:		
Origination and reversal of timing differences	(0.1)	9.6
Decrease in discount	31.6	127.7
Effect of change in rate applied to opening deferred tax balance	(41.0)	(80.9)
Adjustment in respect of prior years	6.4	15.4
Total deferred taxation (credit)/charge	(3.1)	71.8
Total taxation charge on profit on ordinary activities	76.8	122.9

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

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

	2013 £m	2012 £m
Profit on ordinary activities before taxation	311.4	243.7
UK corporation taxation at 24% (2012: 26%)	74.7	63.4
Capital allowances in excess of depreciation	(7.0)	(24.3)
Adjustment in respect of prior years	(4.1)	(11.6)
Other timing differences	(3.8)	(11.1)
Taxation on items taken directly to equity	10.9	25.4
Net non-deductible expenses	9.2	9.3
Actual current taxation charge for the year	79.9	51.1

(c) Taxation on items taken directly to equity

	2013 £m	2012 £m
Current taxation:		
Relating to other pension movements	(10.9)	(25.4)
Deferred taxation:		
On actuarial gains on defined benefit pension schemes	7.6	1.0
Relating to other pension movements	10.6	23.4
Change in taxation rate	0.4	2.9
	18.6	27.3
Total taxation charge on items taken directly to equity	7.7	1.9

Notes to the financial statements (continued)

9. Dividends

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

	2013 £m	2012 £m
Interim dividend for the year ended 31 March 2013 at 24.0 pence per share (2012: 36.7 pence per share)	223.5	342.0

The directors have not recommended a final ordinary dividend (2012: £nil).

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

10. Intangible assets

	Development costs £m	Total £m
Cost		
At 1 April 2012	-	-
Additions	0.6	0.6
At 31 March 2013	0.6	0.6

Development costs have been capitalised in accordance with SSAP 13 'Accounting for research and development'.

11. Tangible assets

	Freehold land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Cost						
At 1 April 2012	229.6	5,660.7	5,285.2	637.3	893.0	12,705.8
Additions	6.5	205.1	65.4	34.1	498.7	809.8
Grants and contributions	-	(18.6)	-	-	-	(18.6)
Transfers	11.7	160.3	168.8	12.0	(352.8)	-
Disposals	(3.3)	(0.4)	(38.2)	(70.4)	-	(112.3)
At 31 March 2013	244.5	6,007.1	5,481.2	613.0	1,038.9	13,384.7
Depreciation						
At 1 April 2012	68.9	2,094.4	1,831.1	387.2	-	4,381.6
Charge for the year	9.6	154.7	225.8	63.2	-	453.3
Disposals	(3.3)	-	(31.8)	(65.8)	-	(100.9)
At 31 March 2013	75.2	2,249.1	2,025.1	384.6	-	4,734.0
Net book value						
At 31 March 2013	169.3	3,758.0	3,456.1	228.4	1,038.9	8,650.7
At 31 March 2012	160.7	3,566.3	3,454.1	250.1	893.0	8,324.2

Notes to the financial statements (continued)

11. Tangible assets (continued)

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (see note 1). As a consequence, the cost of tangible fixed assets is £242.8 million (2012: £224.2 million) lower than it would have been had this treatment not been adopted.

Capital commitments	2013 £m	2012 £m
Contracted but not provided for	371.5	395.4

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

12. Fixed asset investments

	Other investments £m
Cost and net book value at 1 April 2012 and 31 March 2013	0.2

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

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

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

Notes to the financial statements (continued)

13. Debtors

(a) Amounts falling due within one year

	2013 £m	2012 £m
Trade debtors	184.0	173.5
Amounts owed by parent and fellow subsidiary undertakings – trading balances	2.9	2.6
Amounts owed by parent and fellow subsidiary undertakings – floating rate loans	40.0	40.0
Other debtors	17.1	13.9
Prepayments and accrued income	114.4	99.0
Derivative financial instruments (see note 20)	62.0	49.8
	420.4	378.8

(b) Amounts falling due after more than one year

	2013 £m	2012 £m
Derivative financial instruments (see note 20)	505.8	435.5

14. Creditors: amounts falling due within one year

(a) Trade and other creditors

	2013 £m	2012 £m
Trade creditors	47.6	36.0
Amounts owed to parent and fellow subsidiary undertakings	12.2	9.8
Taxation and social security	32.4	48.0
Deferred grants and contributions (see note 16)	6.6	6.4
Accruals and deferred income	335.6	348.9
Derivative financial instruments (see note 20)	3.0	-
	437.4	449.1

(b) Borrowings

	2013 £m	2012 £m
Bonds, bank and other term borrowings	65.0	41.3
Bank overdraft	103.8	8.5
130,000,000 7.0 per cent £1.00 redeemable preference shares	130.0	130.0
Amounts owed to parent and fellow subsidiary undertakings	9.6	20.7
	308.4	200.5

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

Notes to the financial statements (continued)

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

(a) Trade and other creditors

	2013 £m	2012 £m
Other creditors	9.7	11.4
Deferred grants and contributions (see note 16)	72.9	74.4
Derivative financial instruments (see note 20)	206.4	166.4
	289.0	252.2

(b) Borrowings

	2012 £m	2012 £m
Bonds, bank and other term borrowings	5,209.3	4,974.8
Amounts owed to parent and fellow subsidiary undertakings	910.6	813.2
	6,119.9	5,788.0

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

16. Deferred grants and contributions

	2013 £m	2012 £m
At the start of the year	80.8	84.4
Received in the year	5.4	2.9
Credited to the profit and loss account (see note 3)	(6.7)	(6.5)
At the end of the year	79.5	80.8
Represented by:		
Amounts falling due within one year (see note 14a)	6.6	6.4
Amounts falling due after one year (see note 15a)	72.9	74.4
At the end of the year	79.5	80.8

Notes to the financial statements (continued)

17. Provisions for liabilities

	Deferred tax: pension (note 21) £m	Deferred tax: other (note 18) £m	Other £m	Total £m
At 1 April 2012	-	397.4	8.1	405.5
At 1 April 2012 – disclosed separately in pensions (see note 21)	(9.8)	-	-	(9.8)
	(9.8)	397.4	8.1	395.7
Charged/(credited) to profit and loss account	-	(3.1)	6.6	3.5
Taxation charge on items taken directly to equity	18.6	-	-	18.6
Utilised in the year	-	-	(4.8)	(4.8)
	18.6	(3.1)	1.8	17.3
At 31 March 2013 – disclosed separately in pensions (see note 21)	(8.8)	-	-	(8.8)
At 31 March 2013	-	394.3	9.9	404.2

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

18. Deferred tax

Deferred tax is provided as follows:

	2013 £m	2012 £m
Accelerated capital allowances	974.3	1,003.5
Short-term timing differences	(30.0)	(24.5)
Undiscounted provision for deferred tax	944.3	979.0
Discount	(550.0)	(581.6)
Discounted provision for deferred tax (see note 17)	394.3	397.4

Notes to the financial statements (continued)

19. Borrowings

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

	2013 £m	2012 £m
Non-current liabilities		
Bonds	3,863.8	3,765.8
Bank and other term borrowings	1,345.5	1,209.0
Amounts owed to parent and fellow subsidiary undertakings	910.6	813.2
	6,119.9	5,788.0
Current liabilities		
Bonds, bank and other term borrowings	65.0	41.3
Bank overdraft	103.8	8.5
130,000,000 7 per cent £1.00 redeemable preference shares	130.0	130.0
Amounts owed to parent and fellow subsidiary undertakings	9.6	20.7
	308.4	200.5
	6,428.3	5,988.5

Notes to the financial statements (continued)

19. Borrowings (continued)

Terms and debt repayment schedule

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

	Currency	Year of final repayment	2013 Fair value £m	2013 Carrying value £m	2012 Fair value £m	2012 Carrying value £m
Borrowings in fair value hedge relationships						
5.375% 150m bond	GBP	2018	179.9	178.6	177.1	176.1
4.25% 500m bond	EUR	2020	485.3	495.0	460.1	471.7
5.75% 375m bond	GBP	2022	451.5	441.0	430.4	421.6
5.625% 300m bond	GBP	2027	362.4	394.6	340.9	377.8
5.02% JPY 10,000m dual currency loan	JPY/USD	2029	80.1	96.6	76.7	95.6
5.00% 200m bond	GBP	2035	215.6	256.0	202.1	244.6
Borrowings designated at fair value through profit or loss						
1.135% 3,000m bond	JPY	2013	21.0	21.0	22.6	22.6
6.875% 400m bond (owed to intermediate parent undertaking)	USD	2028	302.4	302.4	283.3	283.3
Borrowings measured at amortised cost						
Short-term bank borrowings - fixed	GBP	2013	43.7	43.7	41.0	41.0
6.125% 425m bond	GBP	2015	483.7	428.6	489.7	429.7
1.97% + RPI 200m IL loan	GBP	2016	270.2	248.7	255.4	240.5
1.30% + LIBOR 5,000m (floating) bond	JPY	2017	37.3	35.4	40.9	38.3
2.46% + RPI 50m IL loan	GBP	2020	72.4	56.3	65.4	54.5
2.10% + RPI 50m IL loan	GBP	2020	70.6	56.3	63.6	54.5
1.93% + RPI 50m IL loan	GBP	2020	70.0	56.4	62.9	54.6
1.90% + RPI 50m IL loan	GBP	2020	69.9	56.5	62.9	54.7
1.88% + RPI 50m IL loan	GBP	2020	69.7	56.3	62.6	54.6
1.84% + RPI 50m IL loan	GBP	2020	69.7	56.6	62.6	54.8
1.73% + RPI 50m IL loan	GBP	2020	69.2	56.6	62.2	54.8
1.61% + RPI 50m IL loan	GBP	2020	68.7	56.7	61.7	54.9
0.47% + RPI 100m IL loan	GBP	2023	97.5	99.9	-	-
1.29% + RPI 50m IL loan	GBP	2029	58.3	53.4	49.8	51.6
1.23% + RPI 50m IL loan	GBP	2029	57.9	53.7	49.4	52.0
1.12% + RPI 50m IL loan	GBP	2029	56.4	52.9	48.0	51.3
1.10% + RPI 50m IL loan	GBP	2029	56.1	52.9	47.8	51.2
0.75% + RPI 50m IL loan	GBP	2029	52.1	51.7	43.9	50.1
1.15% + RPI 50m IL loan	GBP	2030	54.9	51.4	46.5	49.7
1.11% + RPI 50m IL loan	GBP	2030	54.2	51.5	45.2	49.9
0.76% + RPI 50m IL loan	GBP	2030	51.9	51.5	43.7	49.9
3.375% + RPI 50m IL bond	GBP	2032	95.9	68.0	86.3	65.8
1.9799% + RPI 100m IL bond	GBP	2035	148.4	127.7	128.3	123.8
1.66% +RPI 35m IL bond	GBP	2037	45.3	41.4	39.3	40.1
2.40% + RPI 70m IL bond	GBP	2039	102.4	80.6	89.1	78.1
1.7829% + RPI 100m IL bond	GBP	2040	143.9	126.4	123.6	122.5
1.3258% + RPI 50m IL bond	GBP	2041	64.7	63.0	55.1	61.1
1.5802% + RPI 100m IL bond	GBP	2042	137.0	126.0	116.7	122.1
1.5366% + RPI 50m IL bond	GBP	2043	68.4	62.9	58.1	60.9

Notes to the financial statements (continued)

19. Borrowings (continued)

	Currency	Year of final repayment	Fair value	2013 Carrying value	Fair value	2012 Carrying value
			£m	£m	£m	£m
Borrowings measured at amortised cost (continued)						
1.397% + RPI 50m IL bond	GBP	2046	66.1	63.0	55.4	61.1
1.7937% + RPI 50m IL bond	GBP	2049	69.9	62.7	61.3	60.8
Commission for New Towns loan - fixed	GBP	2053	55.9	29.9	53.1	30.1
1.847% + RPI 100m IL bond	GBP	2056	142.3	125.0	123.0	121.0
1.815% + RPI 100m IL bond	GBP	2056	140.3	124.4	121.1	120.5
1.662% + RPI 100m IL bond	GBP	2056	133.8	124.2	115.2	120.3
1.591% + RPI 25m IL bond	GBP	2056	32.6	31.0	28.0	30.0
1.5865% + RPI 50m IL bond	GBP	2056	65.3	62.1	56.2	60.1
1.556% + RPI 50m IL bond	GBP	2056	64.7	61.8	55.6	59.8
1.435% + RPI 50m IL bond	GBP	2056	62.0	61.5	53.1	59.6
1.3805% + RPI 35m IL bond	GBP	2056	42.6	43.1	36.5	41.7
1.702% + RPI 50m IL bond	GBP	2057	66.1	60.3	56.8	58.4
1.585% + RPI 100m IL bond	GBP	2057	126.0	119.5	108.2	115.7
Preference shares (owed to immediate parent undertaking)	GBP	2099	130.0	130.0	130.0	130.0
Amounts owed to parent and fellow subsidiary undertakings	GBP	Various	617.8	617.8	550.6	550.6
Other borrowings						
Bank overdrafts	GBP	2013	103.8	103.8	8.5	8.5
			6,757.8	6,428.3	6,007.5	5,988.5

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

Currency:

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

Index-linked debt:

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

20. Financial instruments

Risk management

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

The group treasury committee, a sub-committee of the group board, has responsibility for setting and monitoring the company's adherence to treasury policies, along with oversight in relation to the activities of the treasury function. Treasury policies cover the key financial risks: liquidity risk, credit risk, market risk (inflation, interest rate, electricity price and currency) and capital risk.

Notes to the financial statements (continued)

20. Financial instruments (continued)

These policies are reviewed by the group treasury committee for approval on at least an annual basis, or following any major changes in treasury operations and/or financial market conditions.

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

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

Liquidity risk

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

At 31 March 2013, the company had £662.3 million (2012: £775.4 million) of available liquidity, which comprised £nil (2012: £nil) cash and short-term deposits and £662.3 million (2012: £775.4 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months and bank overdraft are repayable on demand.

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

	2013 £m	2012 £m
Expiring within one year	100.0	125.0
Expiring after one year but in less than two years [1]	775.0	850.0
Expiring after more than two years	190.0	125.0
Total borrowing facilities	1,065.0	1,100.0
Facilities drawn	(402.7)	(324.6)
Undrawn borrowing facilities	662.3	775.4

[1] Figure includes £750.0 million (2012: £750.0 million) facility provided by intermediate parent undertaking.

At 31 March 2013, the company had an additional committed borrowing facility of £80 million expiring after more than two years, £40 million available to be drawn from September 2013 and £40 million available to be drawn from January 2014.

At 31 March 2012, the company had an additional committed borrowing facility of £40 million expiring after more than two years that was available to be drawn from September 2013.

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

Maturity analysis

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

At 31 March 2013	Total[1] £m	Adjustment [2] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Bonds	8,851.2		152.2	131.9	557.7	107.6	145.1	7,756.7
Bank borrowings and other	2,030.5		173.3	26.3	37.0	330.4	55.3	1,408.2
Preference shares	130.0		130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,613.8		36.2	728.8	21.3	21.9	22.5	783.1
Adjustment to carrying value	(6,197.2)	(6,197.2)						
Financial liabilities excluding derivatives and trade and other creditors at amortised cost	6,428.3	(6,197.2)	491.7	887.0	616.0	459.9	222.9	9,948.0
Derivatives:								
Payable	715.9		80.5	85.7	49.6	42.3	71.5	386.3
Receivable	(1,124.5)		(115.0)	(155.9)	(67.0)	(65.5)	(124.2)	(596.9)
Adjustment to carrying value	50.2	50.2						
Derivatives – net assets	(358.4)	50.2	(34.5)	(70.2)	(17.4)	(23.2)	(52.7)	(210.6)

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

1. Forecast future cash flows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are, therefore, susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be 2.65 per cent over the life of each bond.

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Credit risk

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

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

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

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

	2013 £m	2012 £m
Trade and other debtors	358.4	329.0
Derivative financial instruments	567.8	485.3
	926.2	814.3

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2013, the company held £43.7 million (2012: £41.0 million) as collateral in relation to derivative financial instruments (included within borrowings in note 19). In respect of cash and short-term deposits and derivative financial instruments, the company does not have a material exposure to any financial institutions based within the eurozone, with the exception of Germany, and has not experienced any significant credit issues during the financial year.

Market risk

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

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

Inflation risk

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Inflation risk (continued)

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

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

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

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

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

	2013 £m	2012 £m
Index-linked debt	2,853.9	2,667.0

The sensitivity analysis set out below has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2013 and 31 March 2012, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the company's index-linked borrowings.

Increase/(decrease) in profit before taxation and equity

	2013 £m	2012 £m
1 per cent increase in RPI	(29.1)	(27.2)
1 per cent decrease in RPI	29.1	27.2

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

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Interest rate risk

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

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

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

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

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

Sensitivity analysis

The sensitivity analysis below has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2013 and 31 March 2012, respectively. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

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

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

Increase/(decrease) in profit before taxation and equity

	2013	2012
	£m	£m
1 per cent increase in interest rate	96.7	90.8
1 per cent decrease in interest rate	(96.9)	(97.0)

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Repricing analysis

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

At 31 March 2013	**Total**	**1 year or less**	**1-2 years**	**2-3 years**	**3s**	**4-5 years**	**More than 5 years**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowings in fair value hedge relationships							
Fixed rate instruments	1,861.8	-	-	-	-	-	1,861.8
Effect of swaps	-	1,861.8	-	-	-	-	(1,861.8)
	1,861.8	**1,861.8**	**-**	**-**	**-**	**-**	**-**
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	323.4	21.0	-	-	-	-	302.4
Effect of swaps	-	302.4	-	-	-	-	(302.4)
	323.4	**323.4**	**-**	**-**	**-**	**-**	**-**
Borrowings measured at amortised cost							
Fixed rate instruments	632.2	44.0	0.3	429.0	0.4	0.5	158.0
Floating rate instruments	757.0	757.0	-	-	-	-	-
Index-linked instruments	2,853.9	2,853.9	-	-	-	-	-
	4,243.1	**3,654.9**	**0.3**	**429.0**	**0.4**	**0.5**	**158.0**
Effect of a fixed interest rate hedge	-	(2,231.3)	600.0	-	325.0	252.1	1,054.2
Total and net borrowings	**6,428.3**	**3,608.8**	**600.3**	**429.0**	**325.4**	**252.6**	**1,212.2**

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Electricity price risk

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

The company has used electricity swap contracts, to fix the price of a substantial proportion of its anticipated electricity usage out to the end of the AMP in 2015.

Sensitivity analysis

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

Increase/(decrease) in profit before taxation and equity

	2013 £m	2012 £m
10 per cent increase in commodity prices	4.4	4.3
10 per cent decrease in commodity prices	(4.4)	(4.3)

Currency risk

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

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

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

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

Capital risk management

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

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

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

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

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

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

	2013 Fair value £m	2013 Carrying value £m	2012 Fair value £m	2012 Carrying value £m
Financial assets				
Non-current assets				
Derivative financial instruments:				
Fair value hedge derivatives	360.8	360.8	302.3	302.3
Held for trading derivatives [2] [3]	145.0	145.0	133.2	133.2
Total non-current assets	505.8	505.8	435.5	435.5
Current assets				
Cash and short-term deposits	-	-	-	-
Trade and other debtors	358.4	358.4	329.0	329.0
Derivative financial instruments:				
Fair value hedge derivatives	62.0	62.0	48.4	48.4
Held for trading derivatives [2] [3]	-	-	1.4	1.4
Total current assets	420.4	420.4	378.8	378.8
Financial liabilities				
Non-current liabilities				
Trade and other creditors	(82.6)	(82.6)	(85.8)	(85.8)
Borrowings:				
Financial liabilities in a hedge relationship	(1,774.8)	(1,861.8)	(1,687.3)	(1,787.4)
Financial liabilities designated at fair value through profit or loss	(302.4)	(302.4)	(305.9)	(305.9)
Financial liabilities measured at amortised cost	(4,372.2)	(3,955.7)	(3,813.8)	(3,694.7)
	(6,449.4)	(6,119.9)	(5,807.0)	(5,788.0)
Derivative financial instruments:				
Fair value hedge derivatives	-	-	-	-
Held for trading derivatives [2] [3]	(206.4)	(206.4)	(166.4)	(166.4)
Total non-current liabilities	(6,738.4)	(6,408.9)	(6,059.2)	(6,040.2)
Current liabilities				
Trade and other creditors	(434.4)	(434.4)	(449.1)	(449.1)
Borrowings:				
Financial liabilities designated at fair value through profit or loss	(21.0)	(21.0)	-	-
Financial liabilities measured at amortised cost	(287.4)	(287.4)	(200.5)	(200.5)
	(308.4)	(308.4)	(200.5)	(200.5)
Derivative financial instruments:				
Held for trading derivatives [2] [3]	(3.0)	(3.0)	-	-
Total current liabilities	(745.8)	(745.8)	(649.6)	(649.6)
Adjustment for accrued interest [1]	36.2	-	36.0	-
Net financial liabilities	(6,521.8)	(6,228.5)	(5,858.5)	(5,875.5)

Notes to the financial statements (continued)

20. Financial instruments (continued)

Fair values (continued)

(1) Fair values quoted include accrued interest of £36.2 million (2012: £36.0 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other creditors. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

(2) Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £143.5 million (2012: £134.5 million).

(3) Includes amount owed to intermediate parent undertaking £10.2 million (2012: £6.7 million).

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

In respect of the total change during the year in the fair value of financial liabilities designated as at fair value through profit or loss of £17.5 million loss (2012: £19.1 million), a £1.5 million loss (2012: £21.3 million gain) is attributable to changes in own credit risk. The cumulative impact of changes in credit spread was £74.7 million profit (2012: £76.2 million profit). The carrying amount is £99.2 million (2012: £81.7 million) higher than the amount contracted to settle at maturity.

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

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

	Level 1 £m	Level 2 £m	Level 3 £m	2013 Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets	-	567.8	-	567.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	(209.4)	-	(209.4)
Financial liabilities designated as fair value through profit or loss	-	(323.4)	-	(323.4)
	-	35.0	-	35.0

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

Notes to the financial statements (continued)

20. Financial instruments (continued)

Fair values (continued)

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

21. Retirement benefits

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

The last actuarial valuations of UUPS and ESPS were carried out as at 31 March 2010. These valuations have been updated to take account of the requirements of FRS 17 'Retirement Benefits' in order to assess the position at 31 March 2013 by projecting forward from the valuation date, and have been performed by an independent actuary, Aon Hewitt Limited.

The company made total contributions of £68.7 million (2012: £115.0 million) to its pension schemes for the year ended 31 March 2013.

Included in the contributions of £68.7 million (2012: £115.0 million), were regular accelerated deficit repair contributions of £34.7 million (2012: £79.7 million) and an inflation funding mechanism payment of £10.0 million (2012: £7.0 million). Details of the inflation mechanism entered into with the company as part of a pension de-risking strategy, are included within the 2011 Report and Financial Statements.

Overall, the company expects to contribute around £23.8 million to its defined benefit schemes in the year ending 31 March 2014.

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

	2013 % p.a.	2012 % p.a.
Discount rate	4.60	5.00
Expected return on assets*	4.60	4.50
Pensionable salary growth and pension increases	3.30	3.25
Price inflation	3.30	3.25

*The 2012 expected return on assets has been re-presented to show the combined weighted average expected return on assets (the expected return on assets was previously shown separately for the UUPS and ESPS schemes).

Notes to the financial statements (continued)

21. Retirement benefits (continued)

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

	2013 years	2012 years
Retired member – male	26.7	26.5
Non-retired member – male (currently aged 45)	28.5	28.3
Retired member – female	30.0	29.8
Non-retired member – female (currently aged 45)	31.9	31.7

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

	Schemes' assets at 31 March 2013 %	At 31 March 2013 £m	Schemes' assets at 31 March 2012 %	At 31 March 2012 £m
Equities	12.8	208.4	12.6	176.9
Other non-equity growth assets	9.1	148.3	8.2	114.1
Gilts	2.1	33.8	2.0	27.6
Bonds	64.1	1,042.0	61.6	861.5
Other	11.9	194.3	15.6	218.9
Total fair value of assets	100.0	1,626.8	100.0	1,399.0
Present value of liabilities		(1,588.7)		(1,439.9)
Pension surplus/(liability)		38.1		(40.9)
Related deferred tax (liability)/asset (see note 17)		(8.8)		9.8
Net pension surplus/(liability)		29.3		(31.1)

To develop the expected long-term rate of return on asset assumptions, the company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The company's actual return on schemes' assets was a gain of £205.3 million (2012: £225.6 million).

The assets as at 31 March 2013, in respect of the UUPS, included in the breakdown above, have been allocated to each asset class based on the return the assets are expected to achieve and not based on the physical assets held. The reason for this being that the UUPS has entered into a variety of derivative transactions in order to change the return characteristics of the physical assets held and in order to reduce undesirable market and liability risks.

Notes to the financial statements (continued)

21. Retirement benefits (continued)

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

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

	2013 £m	2012 £m
At the start of the year	(1,439.9)	(1,245.2)
Interest cost on pension schemes' obligations	(70.8)	(67.7)
Actuarial losses	(108.8)	(156.8)
Curtailments/settlements arising on reorganisation	(0.6)	(1.9)
Member contributions	(6.3)	(6.3)
Benefits paid	52.5	50.2
Current service cost	(14.8)	(12.2)
At the end of the year	(1,588.7)	(1,439.9)

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

	2013 £m	2012 £m
At the start of the year	1,399.0	1,102.3
Expected return on pension schemes' assets	63.5	64.5
Actuarial gains	141.8	161.1
Member contributions	6.3	6.3
Benefits paid	(52.5)	(50.2)
Company contributions	68.7	115.0
At the end of the year	1,626.8	1,399.0

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

	2013 £m	2012 £m
Current service cost	(14.8)	(12.2)
Curtailments/settlements arising on reorganisation	(0.6)	(1.9)
Pension expense charged to operating profit	(15.4)	(14.1)
Expected return on pension schemes' assets	63.5	64.5
Interest cost on pension schemes' liabilities	(70.8)	(67.7)
Pension expense charged to net interest payable and similar charges (see note 7)	(7.3)	(3.2)
Net pension expense charged before taxation	(22.7)	(17.3)

Notes to the financial statements (continued)

21. Retirement benefits (continued)

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

	2013 £m	2012 £m
At the start of the year	(40.9)	(142.9)
Expense recognised in the profit and loss account	(22.7)	(17.3)
Contributions paid	68.7	115.0
Actuarial gains gross of taxation	33.0	4.3
At the end of the year	38.1	(40.9)

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses. At 31 March 2013, a cumulative pre-tax loss of £81.9 million (2012: £114.9 million) had been recorded directly in the statement of total recognised gains and losses.

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

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Present value of defined benefit obligations	(1,588.7)	(1,439.9)	(1,245.2)	(1,195.3)	(961.1)
Fair value of schemes' assets	1,626.8	1,399.0	1,102.3	1,005.6	797.0
Net retirement benefit obligations	38.1	(40.9)	(142.9)	(189.7)	(164.1)
Experience adjustments on schemes' liabilities (£)	3.9	(22.0)	39.5	3.2	(13.9)
Experience adjustments on schemes' assets (£)	141.8	161.1	14.3	198.6	(270.6)

During the year, the company made £5.5 million (2012: £4.2 million) of contributions to defined contribution schemes.

22. Called up share capital and share premium account

	2013 £m	2012 £m
Allotted and fully paid share capital		
931,930,000 ordinary shares of £1.00 each	931.9	931.9
93,437,000 zero per cent preference shares of £1.00 each	93.4	93.4
130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each	130.0	130.0
	1,155.3	1,155.3
Less: 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each designated as borrowings (see note 19)	(130.0)	(130.0)
	1,025.3	1,025.3
Share premium account	647.8	647.8

Notes to the financial statements (continued)

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

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

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

23. Share capital and reserves

	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m
At 1 April 2012	1,025.3	647.8	344.2	2,017.3
Profit after taxation	-	-	234.6	234.6
Actuarial gains on defined benefit pension schemes (see note 21)	-	-	33.0	33.0
Taxation on items taken directly to equity (see note 8c)	-	-	(7.7)	(7.7)
Dividends paid on equity shares (see note 9)	-	-	(223.5)	(223.5)
At 31 March 2013	1,025.3	647.8	380.6	2,053.7

24. Operating lease commitments

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

	Land and buildings 2013 £m	Plant and machinery 2013 £m	Land and buildings 2012 £m	Plant and machinery 2012 £m
Non-cancellable operating leases which expire:				
Within one year	0.3	0.2	0.1	0.2
Between two and five years	0.5	0.6	0.8	0.6
After five years	2.1	-	1.7	-
	2.9	0.8	2.6	0.8

Notes to the financial statements (continued)

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

	2013 £m	2012 £m
Operating profit	635.3	596.7
Depreciation (see note 3)	453.3	408.5
Amortisation of grants and contributions (see note 3)	(6.7)	(6.5)
Loss on disposal of tangible fixed assets (see note 3)	9.8	8.1
Increase in stocks	(0.6)	(0.4)
Increase in debtors	(29.5)	(19.1)
Increase in creditors	(23.0)	13.7
Movement in other provisions (including pension surplus/liability)	(51.4)	(105.9)
Net cash inflow from operating activities	987.2	895.1

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

	2013 £m	2012 £m
Decrease in cash in the year	-	(0.3)
Increase in overdraft in the year	(95.3)	(1.1)
Net cash inflow from increase in debt and lease financing	(149.6)	(269.6)
Net cash inflow from increase in liquid resources	-	(1.6)
Net cash (inflow)/outflow from derivatives [1]	(6.4)	3.5
Changes in net debt resulting from cash flows	(251.3)	(269.1)
Non-cash adjustments	(149.0)	(194.0)
Movement in net debt in the year	(400.3)	(463.1)
Net debt at 1 April	(5,629.6)	(5,166.5)
Net debt at 31 March	(6,029.9)	(5,629.6)

Non-cash adjustments include fair value movements and indexation.

[1] Cash flows on derivatives consist of £0.7 million financing inflow (2012: £0.7 million) (see note 27) and £nil interest (2012: £nil).

27. Financing

	2013 £m	2012 £m
New loans	634.3	1,342.4
Loans repaid	(467.0)	(1,055.6)
	167.3	286.8
Financing cash flows on derivatives	0.7	0.7
Net cash inflow from financing	168.0	287.5

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

Notes to the financial statements (continued)

28. Analysis of changes in net debt

	At 1 April 2012 £m	Cash flow £m	Non-cash movements £m	At 31 March 2013 £m
Overdraft	(8.5)	(95.3)	-	(103.8)
Parent and fellow subsidiary undertaking loans	40.0	-		40.0
	31.5	(95.3)	-	(63.8)
Debt due after one year	(5,788.0)	(158.1)	(173.8)	(6,119.9)
Debt due within one year	(192.0)	8.5	(21.1)	(204.6)
	(5,980.0)	(149.6)	(194.9)	(6,324.5)
Net debt excluding derivatives	(5,948.5)	(244.9)	(194.9)	(6,388.3)
Derivatives	318.9	(6.4)	45.9	358.4
Net debt including derivatives	(5,629.6)	(251.3)	(149.0)	(6,029.9)

29. Related party transactions

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

	2013 £m	2012 £m
Sales of services	0.4	0.1
Purchases of goods and services	0.7	0.3

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

No guarantees have been given or received. No amounts have been written-off during the year (2012: £nil).

30. Ultimate parent undertaking and controlling party

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

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

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

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

Regulatory accounting information

Introduction

The Regulatory Accounts on pages 79 to 113 have been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Water Services Regulation Authority ('WSRA').

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

The regulatory financial statements should be read in conjunction with the statutory Annual Report and Financial Statements which include the Directors' report (pages 23 to 32), which includes information in respect of the company's charitable donations (page 23) and a statement as to the disclosure of information to the auditor (page 32), and the dividend policy of the Company which also applies to the appointed business (page 5).

Statement of directors' responsibilities for regulatory information

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

This additionally requires the directors to:

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

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

Ring fencing

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

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

We have audited the Regulatory Accounts of United Utilities Water PLC for the year ended 31 March 2013 on pages 83 to 111 which comprise:

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

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

This report is made, on terms that have been agreed, solely to the company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewerage undertaker under the Water Industry Act 1991. Our audit work has been undertaken so that we might state to the company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the WSRA, the directors and auditor

As explained more fully in the statement of directors' responsibilities set out on page 79, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditor.

Scope of the audit of the Regulatory Accounts

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

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

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

Opinion on Regulatory Accounts

In our opinion, the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 88 to 92, the state of the company's affairs at 31 March 2013 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies (including the accounting separation methodology).

Basis of preparation

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

The Regulatory Accounts are separate from the statutory financial statements of the company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP') or International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 83 to 85 have been drawn up in accordance with Regulatory Accounting Guideline 3.07, in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given in note 8 on pages 104 to 107.

Opinion on other matters prescribed by Condition F

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

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

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

Other matters

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

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2013 on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our 'statutory audit') was made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

KPMG Audit Plc
Chartered Accountants
St James' Square
Manchester
M2 6DS
4 June 2013

Notes:

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

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

Historical cost profit and loss account

For the 12 months ended 31 March

	2013 Appointed £m	2013 Non-appointed £m	2013 Total £m	2012 Appointed £m	2012 Non-appointed £m	2012 Total £m
Turnover	1,622.9	8.6	1,631.5	1,553.3	8.5	1,561.8
Operating costs	(533.2)	(3.5)	(536.7)	(528.3)	(2.8)	(531.1)
Operating costs – exceptional items(a)	(2.6)	-	(2.6)	(22.8)	-	(22.8)
Infrastructure renewals charge (b)	(149.6)	-	(149.6)	(141.6)	-	(141.6)
Historical cost depreciation	(291.7)	(0.2)	(291.9)	(262.7)	(0.1)	(262.8)
Operating expense	(9.9)	-	(9.9)	(8.1)	-	(8.1)
Operating profit	635.9	4.9	640.8	589.8	5.6	595.4
Other income	-	1.3	1.3	-	1.4	1.4
Net interest	(323.9)	-	(323.9)	(353.0)	-	(353.0)
Profit on ordinary activities before taxation	312.0	6.2	318.2	236.8	7.0	243.8
Current tax	(78.4)	(1.5)	(79.9)	(49.4)	(1.8)	(51.2)
Deferred tax	1.2	-	1.2	(72.4)	-	(72.4)
Profit on ordinary activities after taxation	234.8	4.7	239.5	115.0	5.2	120.2
Dividends	(218.3)	(5.2)	(223.5)	(338.5)	(3.5)	(342.0)
Retained profit/(loss) for the year	16.5	(0.5)	16.0	(223.5)	1.7	(221.8)

Note: Details of reconciling items between the historical cost regulatory accounts and the statutory accounts are provided in note 8.

(a) Historical cost operating profit before exceptional items of £638.5 million (2012: £612.6 million) for the appointed business is stated prior to exceptional costs of £2.6 million (2012: £22.8 million). Exceptional costs comprise of restructuring costs of £2.6 million (2012: £2.6 million). In the prior year there were £20.2million of pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished. There are no equivalent costs in the current year.

(b) In the 2012 Regulatory Accounts the infrastructure renewals charge was reported within operating costs. For Regulatory Reporting 2013 we are required to report the infrastructure renewals charge as a separate line item. For comparative purposes we have restated operating costs for 2012 by the £141.6m that related to the infrastructure renewals charge and is now reported on a separate line.

Statement of total recognised gains and losses (historical cost accounting)

For the 12 months ended 31 March (appointed business only)

	2013 £m	2012 £m
Profit for the year (before dividends)	234.8	115.0
Actuarial gains on post employment plans (net of deferred taxation)	25.4	2.4
Total recognised gains for the year	260.2	117.4

Historical cost balance sheet

As at 31 March

	2013 Appointed £m	2013 Non - appointed £m	2013 Total £m	2012 Appointed £m	2012 Non - appointed £m	2012 Total £m
Fixed assets						
Tangible fixed assets	8,582.2	1.2	8,583.4	8,253.6	1.3	8,254.9
Investments – other	0.2	-	0.2	0.2	-	0.2
Total fixed assets	8,582.4	1.2	8,583.6	8,253.8	1.3	8,255.1
Infrastructure renewals prepayment	11.0	-	11.0	7.4	-	7.4
Other current assets	1,029.7	7.0	1,036.7	878.2	7.2	885.4
Creditors: amounts falling due within one year						
Borrowings	(74.6)	-	(74.6)	(62.0)	-	(62.0)
Other creditors	(598.5)	(3.5)	(602.0)	(507.8)	(3.3)	(511.1)
Total creditors: amounts falling due within one year	(673.1)	(3.5)	(676.6)	(569.8)	(3.3)	(573.1)
Net current assets	367.6	3.5	371.1	315.8	3.9	319.7
Total assets less current liabilities	8,950.0	4.7	8,954.7	8,569.6	5.2	8,574.8
Creditors: amounts falling due after one year						
Borrowings	(6,119.8)	-	(6,119.8)	(5,788.0)	-	(5,788.0)
Other creditors	(216.3)	-	(216.3)	(177.9)	-	(177.9)
Total creditors: amounts falling due after one year	(6,336.1)	-	(6,336.1)	(5,965.9)	-	(5,965.9)
Provisions for liabilities and charges	(476.0)	-	(476.0)	(507.8)	-	(507.8)
Preference share capital	(130.0)	-	(130.0)	(130.0)	-	(130.0)
Net assets employed	2,007.9	4.7	2,012.6	1,965.9	5.2	1,971.1
Capital and reserves	2,007.9	4.7	2,012.6	1,965.9	5.2	1,971.1

Note:
Details of reconciling items between the historical cost regulatory accounts and the statutory accounts are provided in note 8.

Current cost profit and loss account

For the 12 months ended 31 March (appointed business only)

	Note	2013 Water £m	2013 Sewerage £m	2013 Total £m	2012 Water £m	2012 Sewerage £m	2012 Total £m
Turnover							
Unmeasured household		378.3	395.5	773.8	376.6	389.8	766.4
Unmeasured non-household		4.5	5.4	9.9	4.6	5.7	10.3
Measured household		158.0	179.1	337.1	141.2	157.7	298.9
Measured non-household		132.1	230.0	362.1	127.8	214.7	342.5
Trade effluent		-	19.2	19.2	-	19.6	19.6
Bulk supplies/inter company payments		0.6	0.1	0.7	0.6	0.1	0.7
Other third party services (incl non-potable water)		6.3	-	6.3	6.7	-	6.7
Other sources		57.8	56.0	113.8	55.6	52.6	108.2
Total turnover		737.6	885.3	1,622.9	713.1	840.2	1,553.3
Current cost operating costs - wholesale	2	(428.3)	(528.3)	(956.6)	(399.0)	(483.7)	(882.7)
Current cost operating costs - retail	2	(71.2)	(78.8)	(150.0)	(88.3)	(104.0)	(192.3)
Operating income		(2.1)	(8.9)	(11.0)	(2.4)	(6.2)	(8.6)
Working capital adjustment		1.2	1.4	2.6	0.9	1.1	2.0
Current cost operating profit (a)		237.2	270.7	507.9	224.3	247.4	471.7
Net interest				(323.9)			(353.0)
Financing adjustment				100.9			111.6
Current cost profit before taxation				284.9			230.3
Net revenue movement out of tariff basket		-	0.2	0.2	0.9	1.9	2.8

(a) Current cost operating profit before exceptional items of £510.5 million (2012: £494.5 million) is stated prior to exceptional costs of £2.6 million (2012: £22.8 million). Exceptional costs comprise of restructuring costs of £2.6 million (2012: £2.6 million). In the prior year there were £20.2m of pre AMP 5 costs arising from a management review of the best estimate of those future contractual liabilities which should not be derecognised until they are legally extinguished. There are no equivalent costs in the current year.

Current cost cash flow statement

For the 12 months ended 31 March (appointed business only)

	2013 £m	2012 £m
Current cost operating profit	507.9	471.7
Working capital adjustment	(2.5)	(2.0)
Movement in working capital	(58.2)	35.8
Receipts from other income	-	0.2
Current cost depreciation (net of amortisation of deferred contributions)	421.3	382.3
Current cost loss on sale of fixed assets	11.0	8.6
Infrastructure renewals charge	149.5	141.6
Movement in provisions	(48.8)	(106.6)
Net cash inflow from operating activities	980.2	931.6
Returns on investments and servicing of finance	(183.9)	(171.5)
Taxation paid	(83.0)	(11.7)
Capital expenditure and financial investment		
Gross cost of purchase of fixed assets	(622.7)	(591.6)
Receipt of grants and contributions	24.0	31.3
Infrastructure renewals expenditure	(160.9)	(141.8)
Disposal of fixed assets	1.3	1.7
Net cash outflow from investing activities	(758.3)	(700.4)
Equity dividends paid	(218.3)	(338.5)
Net cash flow from management of liquid resources	-	1.6
Net cash outflow before financing	(263.3)	(288.9)
Net cash inflow from financing	168.0	287.5
Decrease in cash and overdraft	(95.3)	(1.4)

Notes to the current cost accounts

1. Accounting policies

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

Tangible fixed assets

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

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

Operational assets

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

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

Infrastructure assets

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

Other fixed assets

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

Surplus land

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

Capitalisation policy

The company's capitalisation policy for the Regulatory Accounts is based on the Regulatory Accounting Guidelines (RAGs) framework, particularly Regulatory Accounting Guideline 2.04 'Guideline for Capitalisation of Capital Expenditure'. Where the RAGs do not address a particular capital accounting issue, UK Generally Accepted Accounting Practice is followed. In summary:

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

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

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

Notes to the current cost accounts (continued)

1. Accounting policies (continued)

In accordance with regulatory accounting guideline 4.04 – 'Guideline for the definitions for the regulatory accounts tables', published in February 2013, customer meters have been transferred from the Retail business unit to the Treated Water Distribution business unit. The transfer has been reflected in the regulatory tables with an effective date of 1 April 2012. The total value of this transfer was £249.3million (cost) and £73.4million (net book value).

Allocation of fixed assets to business activities

Fixed assets are allocated directly to the business area to which they relate where possible, as defined in Ofwat's Regulatory Accounting Guideline 4.04. Shared assets are allocated based on an activity basis using quantitative measures reflecting utilisation of the assets.

Grants and other third party contributions

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

Real financial capital maintenance adjustments

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

Working capital adjustment

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

Financing adjustment

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

Accounting Separation

The accounts have been drawn up in accordance with our separately published accounting separation methodology statement.

Allocation of costs to principal services

Direct costs are charged to the sub-service areas to which they are attributable, as defined in Ofwat's Regulatory Accounting Guideline 4.04. Business activities and indirect costs are allocated on an activity basis using quantitative measures such as headcount and other methods reflecting consumption of service.

Amounts given to charitable trusts assisting customers

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

Appointed and non-appointed activities

The company has used the guidance in Ofwat's Regulatory Accounting Guideline 3.07 in determining which of its activities are appointed or non-appointed. In summary, the appointed business is defined as the regulated activities of the Appointee, i.e. those necessary to fulfil the functions and duties of a water and sewerage undertaker. The non-appointed business encompasses those activities for which the company is not a monopoly supplier or those activities which involve the optional use of an asset owned by the appointed business. Direct costs attributable to the provision of services other than the appointed business are separately allocated and identified as non-appointed. Indirect costs, relating to non-appointed activities, are allocated based upon activities undertaken during the year.

Notes to the current cost accounts (continued)

1. Accounting policies (continued)

Revenue recognition policy

Turnover represents the income receivable in the ordinary course of business from the regulated activities of the business in the year exclusive of value added tax. Charges billed to customers for water and sewerage services are recognised in the period in which they are earned. An accrual is estimated for measured consumption that has not yet been billed.

The measured income accrual is an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. The measured income accrual is recognised within turnover.

Where an invoice has been raised or payment made but the service has not been provided in the year this will be treated as a payment in advance. This will not be recognised within the current year's turnover but will instead be recognised within creditors.

Charges on income arising from court, solicitors and debt recovery agency fees are credited to operating costs and added to the relevant customer account. They are not recognised within turnover.

Revenue recognition differences between statutory and regulatory accounts

The following differences exist between the revenue recognition policies in the statutory accounts and in the regulatory accounts.

- FRS 5 has been applied in full in the statutory accounts however Application Note G of FRS 5 has not been applied to the regulatory accounts. This means that revenue is recognised in full in the regulatory accounts regardless of payment history or whether the company has the occupier's name (provided the property has not been confirmed as being a void property).
- Rental income is recognised within turnover in the statutory accounts however in the regulatory accounts it is recognised within other income below operating profit.
- Income from energy generation, exported energy, renewable obligation certificates and ROC bonuses is treated as turnover in the statutory accounts but as negative operating expenditure in the regulatory accounts.
- Infrastructure charges relating to new customers are recognised as turnover in the statutory accounts but credited to fixed assets in the regulatory accounts.
- Commission income and management fees from related parties are recognised as turnover in the statutory accounts but included within other income below operating profit in the regulatory accounts.
- Non-appointed income is included within turnover in the statutory accounts but is excluded from the regulatory accounts.

Charging policy

Water and sewerage charges fall into the following three categories:

- Charges which are payable in full
- Charges which are payable in part
- Not chargeable (void properties)

The circumstances in which each of the above applies are set out below.

Notes to the current cost accounts (continued)

1. Accounting policies (continued)

Charges payable in full

Charges are payable in full in the following circumstances:

Occupied and furnished

Water (and sewerage) charges are payable in full when premises are occupied or furnished from either the date of connection or the date of occupation

Unoccupied and furnished

Water (and sewerage) charges are payable in full on unoccupied furnished premises. Exceptions to this, where water (and sewerage) charges are not payable, include where the occupier is:

- a sole occupier in a care home
- a sole occupier in long-term hospitalisation
- a sole occupier in prison
- in the event of the death of a sole occupier.

Unoccupied and unfurnished where there is evidence of consumption

Water (and sewerage) charges are payable in full on unoccupied, unfurnished premises where there is evidence of consumption. This includes:

- premises where renovation, redecoration or building work is being undertaken
- premises being used as storage
- premises not normally regarded as being occupied such as cattle troughs and car parks.

Charges payable in part

The following charges only are payable in certain circumstances:

Metered standing charges

Payable on unoccupied, metered properties which remain furnished.

Surface water drainage and highway drainage charges

Payable on unmeasured properties which are temporarily disconnected.

Not chargeable

Properties which are unoccupied, unfurnished and disconnected are not chargeable for water and sewerage therefore no billing is raised and no turnover recognised in respect of these properties.

Definition and treatment of properties

Occupied properties

The occupier is any person in actual occupation or who owns a premise or who has agreed with us to pay water and sewerage services in respect of the premises.

The property management process is followed to identify whether the property is occupied or not and if occupied to identify the chargeable person and raise a bill.

Notes to the current cost accounts (continued)

1. Accounting policies (continued)

The property management process may comprise some or all of the following:

- physical inspection
- mailings
- customer contacts
- meter readings for metered properties
- land registry checks.

When a new customer is identified they may be required to provide documentary evidence to establish the date that they became responsible for water and sewerage charges at the property. This is normally the date at which they moved into the property. The new customer will be charged retrospectively from the date at which they became responsible for water and sewerage charges of the premises.

Unoccupied properties

If the property management process confirms that the property is unoccupied, the property may be declared void and the supply may be turned off.

New properties

All new properties are metered. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

Bad debt policy

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

Notes to the current cost accounts (continued)

2. Current cost operating costs analysis for the wholesale and retail business

Current cost operating cost accounting separation tables have been included for March 2013 in order to comply with the requirements of Information Notice 13/01.

Operating cost analysis for the 12 months ended 31 March 2013 (wholesale business only) - Water

	Water Resources £m	Raw water distribution £m	Water Treatment £m	Water Treated distribution £m	Water sub-total £m
Operating expenditure					
Power	1.7	2.5	8.8	8.1	21.1
Income treated as negative expenditure	-	(0.3)	-	-	(0.3)
Service charges	19.6	-	0.3	-	19.9
Bulk supply imports	1.5	-	-	-	1.5
Other operating expenditure	14.3	4.3	46.8	34.2	99.6
Local authority rates	15.6	4.3	6.1	31.2	57.2
Exceptional items	0.3	-	0.4	0.3	1.0
Total operating expenditure excluding third party services	53.0	10.8	62.4	73.8	200.0
Capital maintenance					
Infrastructure renewals charge	17.7	0.9	-	53.2	71.8
Current cost depreciation	14.6	2.3	63.2	76.8	156.9
Amortisation of deferred credits	(0.6)	-	(0.8)	(4.2)	(5.6)
Total capital maintenance excluding third party services	31.7	3.2	62.4	125.8	223.1
Third party services					
Operating expenditure	1.2	1.0	0.3	0.7	3.2
Current cost depreciation	1.8	0.1	0.1	-	2.0
Total operating costs	87.7	15.1	125.2	200.3	428.3

Operating cost analysis for the 12 months ended 31 March 2013 (wholesale business only) - Sewerage

	Sewage collection £m	Sewage treatment £m	Sludge treatment £m	Sludge disposal £m	Sewerage Sub-total £m
Operating expenditure					
Power	3.8	23.5	7.2	2.7	37.2
Income treated as negative expenditure	-	-	(3.2)	-	(3.2)
Service charges	1.8	4.3	0.5	0.1	6.7
Other operating expenditure	36.0	57.0	22.2	19.7	134.9
Local authority rates	3.0	15.5	4.3	-	22.8
Exceptional items	0.3	0.6	0.2	0.2	1.3
Total operating expenditure excluding third party services	44.9	100.9	31.2	22.7	199.7
Capital maintenance					
Infrastructure renewals charge	74.4	1.3	2.0	-	77.7
Current cost depreciation	38.1	172.9	42.5	1.6	255.1
Amortisation of deferred credits	(3.8)	(0.4)	-	-	(4.2)
Total capital maintenance excluding third party services	108.7	173.8	44.5	1.6	328.6
Total operating costs	153.6	274.7	75.7	24.3	528.3

Notes to the current cost accounts (continued)

2. Current cost operating costs analysis for the wholesale and retail business (continued)

Operating cost analysis for the 12 months ended 31 March 2013 (wholesale business only)

	Water sub-total £m	Sewerage sub-total £m	Wholesale Total £m
Operating expenditure			
Power	21.1	37.2	58.3
Income treated as negative expenditure	(0.3)	(3.2)	(3.5)
Service charges	19.9	6.7	26.6
Bulk supply imports	1.5	-	1.5
Other operating expenditure	99.6	134.9	234.5
Local authority rates	57.2	22.8	80.0
Exceptional items	1.0	1.3	2.3
Total operating expenditure excluding third party services	200.0	199.7	399.7
Capital maintenance			
Infrastructure renewals charge	71.8	77.7	149.5
Current cost depreciation	156.9	255.1	412.0
Amortisation of deferred credits	(5.6)	(4.2)	(9.8)
Total capital maintenance excluding third party services	223.1	328.6	551.7
Third party services			
Operating expenditure	3.2	-	3.2
Current cost depreciation	2.0	-	2.0
Total operating costs	428.3	528.3	956.6

Operating cost analysis for the 12 months ended 31 March 2013 (retail business only)

	Household £m	Non-household £m	Total £m
Operating expenditure			
Customer services	26.6	4.6	31.2
Debt management	12.3	3.3	15.6
Doubtful debts	57.9	6.1	64.0
Meter reading	5.8	2.1	7.9
Other operating expenditure	10.9	2.6	13.5
Local authority rates	0.3	0.1	0.4
Exceptional items	0.2	0.1	0.3
Total operating expenditure	114.0	18.9	132.9
Capital maintenance			
Current cost depreciation	15.7	1.4	17.1
Total capital maintenance	15.7	1.4	17.1
Total operating costs	129.7	20.3	150.0
Debt written off	43.7	7.3	51.0

Notes to the current cost accounts (continued)

3. Current cost analysis of fixed assets

Current cost analysis of fixed assets – Water

	Water Resources £m	Raw water distribution £m	Water Treatment £m	Water Treated distribution £m	Water sub-total £m
Non-infrastructure assets					
Gross replacement cost					
At 1 April 2012	484.9	82.0	2,210.4	2,265.3	5,042.6
Reclassification adjustment	7.1	1.1	(3.8)	235.1	239.5
RPI adjustment	15.9	2.7	71.4	82.0	172.0
Disposals	(3.5)	(1.6)	(28.4)	(25.9)	(59.4)
Additions	15.9	1.0	79.6	47.8	144.3
At 31 March 2013	520.3	85.2	2,329.2	2,604.3	5,539.0
Depreciation					
At 1 April 2012	(233.1)	(46.6)	(1,184.5)	(1,194.2)	(2,658.4)
Reclassification adjustment	(4.2)	(0.1)	3.1	(167.0)	(168.2)
RPI adjustment	(7.6)	(1.5)	(37.9)	(44.4)	(91.4)
Disposals	3.1	1.6	27.4	24.1	56.2
Charge for year	(16.4)	(2.3)	(63.3)	(76.8)	(158.8)
At 31 March 2013	(258.2)	(48.9)	(1,255.2)	(1,458.3)	(3,020.6)
Net book amount at 31 March 2013	262.1	36.3	1,074.0	1,146.0	2,518.4
Net book amount at 1 April 2012	251.8	35.4	1,025.9	1,071.1	2,384.2
Infrastructure assets					
Gross replacement cost					
At 1 April 2012	5,190.3	1,477.2	8.4	9,178.2	15,854.1
Reclassification adjustment	(0.6)	(0.1)	(1.1)	1.2	(0.6)
RPI adjustment	170.3	48.5	0.2	300.9	519.9
Disposals	-	-	-	(0.1)	(0.1)
Additions	4.6	-	8.9	51.4	64.9
At 31 March 2013	5,364.6	1,525.6	16.4	9,531.6	16,438.2

Notes to the current cost accounts (continued)

3. Current cost analysis of fixed assets (continued)

Current cost analysis of fixed assets – Sewerage

	Sewage collection £m	Sewage treatment £m	Sludge treatment £m	Sludge disposal £m	Sewerage sub-total £m
Non-infrastructure assets					
Gross replacement cost					
At 1 April 2012	1,093.6	5,418.6	1,507.1	19.8	8,039.1
Transfer of private pumping stations[1]	6.8	-	-	-	6.8
Reclassification adjustment	7.7	(2.1)	5.8	(2.1)	9.3
RPI adjustment	35.3	175.3	48.4	0.6	259.6
Disposals	(16.6)	(58.2)	(33.7)	(0.7)	(109.2)
Additions	82.8	174.4	22.6	6.9	286.7
At 31 March 2013	1,209.6	5,708.0	1,550.2	24.5	8,492.3
Depreciation					
At 1 April 2012	(551.7)	(2,844.6)	(800.7)	(5.2)	(4,202.2)
Transfer of private pumping stations[1]	(4.6)	-	-	-	(4.6)
Reclassification adjustment	(0.8)	6.3	(6.2)	(0.6)	(1.3)
RPI adjustment	(17.8)	(91.7)	(25.5)	(0.2)	(135.2)
Disposals	15.7	52.1	32.7	0.4	100.9
Charge for year	(38.0)	(173.0)	(42.5)	(1.6)	(255.1)
At 31 March 2013	(597.2)	(3,050.9)	(842.2)	(7.2)	(4,497.5)
Net book amount at 31 March 2013	612.4	2,657.1	708.0	17.3	3,994.8
Net book amount at 1 April 2012	541.9	2,574.0	706.4	14.6	3,836.9
Infrastructure assets					
Gross replacement cost					
At 1 April 2012	53,515.7	287.2	35.7	-	53,838.6
Reclassification adjustment	(2.4)	-	0.2	-	(2.2)
RPI adjustment	1,755.2	9.4	1.2	-	1,765.8
Disposals	(0.3)	-	-	-	(0.3)
Additions	169.9	3.4	-	-	173.3
At 31 March 2013	55,438.1	300.0	37.1	-	55,775.2

Note:

[1] - The ownership of, and responsibility for, certain private sewer pumping stations in UUW's region were transferred to the company during 2012-13. To meet the requirements of RAG1.05, these assets have been included in fixed assets at their modern equivalent asset (MEA) value with a corresponding credit to third party contributions. The gross MEA value is based on construction unit costs for similar pumping stations within the public sewer network. The net MEA value is based on an engineering assessment of the remaining service potential of these assets. This valuation will be reviewed as further data becomes available.

Notes to the current cost accounts (continued)

3. Current cost analysis of fixed assets (continued)

Current cost analysis of fixed assets – Wholesale

	Water sub-total £m	Sewerage sub-total £m	Wholesale total £m
Non-infrastructure assets			
Gross replacement cost			
At 1 April 2012	5,042.6	8,039.1	13,081.7
AMP adjustment	-	6.8	6.8
Reclassification adjustment	239.5	9.3	248.8
RPI adjustment	172.0	259.6	431.6
Disposals	(59.4)	(109.2)	(168.6)
Additions	144.3	286.7	431.0
At 31 March 2013	5,539.0	8,492.3	14,031.3
Depreciation			
At 1 April 2012	(2,658.4)	(4,202.2)	(6,860.6)
AMP adjustment	-	(4.6)	(4.6)
Reclassification adjustment	(168.2)	(1.3)	(169.5)
RPI adjustment	(91.4)	(135.2)	(226.6)
Disposals	56.2	100.9	157.1
Charge for year	(158.8)	(255.1)	(413.9)
At 31 March 2013	(3,020.6)	(4,497.5)	(7,518.1)
Net book amount at 31 March 2013	2,518.4	3,994.8	6,513.2
Net book amount at 1 April 2012	2,384.2	3,836.9	6,221.1
Infrastructure assets			
Gross replacement cost			
As at 1 April 2012	15,854.1	53,838.6	69,692.7
Reclassification adjustment	(0.6)	(2.2)	(2.8)
RPI adjustment	519.9	1,765.8	2,285.7
Disposals	(0.1)	(0.3)	(0.4)
Additions	64.9	173.3	238.2
At 31 March 2013	16,438.2	55,775.2	72,213.4

Notes to the current cost accounts (continued)

3. Current cost analysis of fixed assets (continued)

Current cost analysis of fixed assets – Retail

	Household £m	Non-household £m	Total £m
Non infrastructure assets			
Gross replacement cost			
At 1 April 2012	321.3	107.1	428.4
Reclassification adjustment	(154.6)	(91.0)	(245.6)
RPI adjustment	4.0	0.4	4.4
Disposals	(29.5)	(2.3)	(31.8)
Additions	15.9	2.5	18.4
At 31 March 2013	157.1	16.7	173.8
Depreciation			
At 1 April 2012	(198.3)	(83.4)	(281.7)
Reclassification adjustment	94.8	74.7	169.5
RPI adjustment	(2.5)	(0.2)	(2.7)
Disposals	28.8	2.1	30.9
Charge for year	(15.7)	(1.4)	(17.1)
At 31 March 2013	(92.9)	(8.2)	(101.1)
Net book amount at 31 March 2013	64.2	8.5	72.7
Net book amount at 1 April 2012	123.0	23.7	146.7

Notes to the current cost accounts (continued)

4. Analysis of capital expenditure, grants and land sales

For the 12 months ended 31 March

	2013			2012		
	Gross £m	Grants and contributions £m	Net £m	Gross £m	Grants and contributions £m	Net £m
Capital expenditure - water						
Base						
Infrastructure Renewals Expenditure (IRE)	85.6	(3.2)	82.4	71.6	(8.9)	62.7
Maintenance non-infrastructure (MNI)	106.1	(1.7)	104.4	79.4	(0.7)	78.7
Enhancements						
Infrastructure enhancements	62.4	(7.9)	54.5	66.2	(7.2)	59.0
Non-infrastructure enhancements	46.6	(1.6)	45.0	35.8	(0.7)	35.1
Total capital expenditure – water	300.7	(14.4)	286.3	253.0	(17.5)	235.5
Grants and contributions - water						
Developer contributions (i.e. Enhancement requisitions, grants and contributions)		(5.2)			(3.9)	
Infrastructure charges receipts – new connections		(4.0)			(3.7)	
Other contributions		(5.2)			(9.9)	
Total grants and contributions		(14.4)			(17.5)	
Capital expenditure - sewerage						
Base						
Infrastructure Renewals Expenditure (IRE)	75.3	(4.5)	70.8	88.5	(9.5)	79.0
Maintenance non-infrastructure (MNI)	163.5	(0.3)	163.2	142.9	-	142.9
Enhancements						
Infrastructure enhancements	139.2	(3.1)	136.1	133.0	(2.9)	130.1
Non-infrastructure enhancements	131.6	(1.8)	129.8	102.0	(1.5)	100.5
Total capital expenditure – sewerage	509.6	(9.7)	499.9	466.4	(13.9)	452.5
Grants and contributions - sewerage						
Developer contributions (i.e. Enhancement requisitions, grants and contributions)		(0.9)			(0.8)	
Infrastructure charges receipts – new connections		(4.0)			(3.6)	
Other contributions		(4.8)			(9.5)	
Total grants and contributions – sewerage		(9.7)			(13.9)	
Total capital expenditure - water and sewerage	810.3	(24.1)	786.2	719.4	(31.4)	688.0
Land sales – Proceeds from disposals of protected land			2.7			2.7

Note:
In addition to the capital expenditure in note 4 above, assets adopted at nil cost during the year, for example sewers adopted from developers, are included as fixed asset additions in note 3 at their gross MEA value of £38.2million.

Notes to the current cost accounts (continued)

5. Analysis of working capital

		2013 £m	2012 £m
Stock		5.7	5.0
Trade debtors:	Measured household	39.1	34.4
	Unmeasured household	96.1	93.1
	Measured non-household	37.6	34.5
	Unmeasured non-household	8.2	9.9
	Other	28.6	18.9
Measured income accrual		136.7	123.0
Prepayments and other debtors		40.0	20.1
Trade creditors		(66.1)	(39.3)
Deferred income – customer advance receipts		(137.2)	(136.6)
Short-term capital creditors		(145.8)	(119.2)
Accruals and other creditors		(88.8)	(121.3)
Total working capital		(45.9)	(77.5)
Total revenue outstanding – household		308.7	277.7
Total revenue outstanding – non-household		64.5	61.6

Notes to the current cost accounts (continued)

6. Analysis of net debt, gearing and interest costs

	Fixed rate £m	Floating rate £m	Index-linked £m	2013 Total £m
Borrowings (excluding preference shares)	2,687.4	653.2	2,853.9	6,194.5
Preference share capital				130.0
Total borrowings				6,324.5
Bank overdraft				103.8
Short-term deposits (intercompany loans)				(40.0)
Net debt excluding derivatives				6,388.3
Regulatory capital value				9,365.0
Gearing				68.2%
Full year equivalent nominal interest cost	131.4	2.9	142.9	277.2
Full year equivalent cash interest payment	131.4	2.9	47.6	181.9
Indicative interest rates				
Indicative weighted average nominal interest rate	4.67%	2.48%	5.00%	4.79%
Indicative weighted average cash interest rate	4.67%	2.48%	1.67%	3.14%
Weighted average years to maturity	4.9		23.6	17.5

All figures in the table have been calculated by reference to 'RAG 4.04- Guideline for the definitions for the regulatory accounts tables'.

Net debt excluding derivatives represents the carrying value in the company statutory accounts and does not take account of the impact on interest of derivative instruments.

Indicative weighted average interest rates are based upon the effective interest rates as at the balance sheet date, which includes the impact of derivative instruments but excludes those with a forward start date, weighted by the notional principal amount.

Weighted average years to maturity takes account of all applicable contractual commitments, which includes derivative instruments with a forward start date, weighted by notional principal amount and duration.

Due to the nature of the company's interest rate hedging policy, it has some forward starting interest rate swaps which are not included in the indicative weighted average interest rates as they are not effective at the balance sheet date, but have been taken into account in the calculation of the weighted average years to maturity, as they extend the duration of our interest rate fixing. As a result the indicative weighted average interest rates are only representative of our economic cost of borrowing as at the balance sheet date and are not representative of our economic cost of borrowing over the duration of the fixed interest rate hedge.

Annual RPI increase of 3.3% at March 2013 has been applied. The analysis above includes the impact of preference shares.

Notes to the current cost accounts (continued)

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

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

Borrowings and sums lent

The following loans from associated companies existed at 31 March 2013

	£m	Interest rate	Repayment date
United Utilities PLC: $400.0 million bond	302.4	6.875%	August 2028
United Utilities Finance Holdings Limited: £205.5 million loan	205.5	0.745%+LIBOR	July 2034
United Utilities PLC: Loan facility of £750.0 million	402.7	0.05%+LIBOR	On at least 18 months notice
United Utilities PLC: overdraft facility	9.6	0.5%+LIBOR	On demand
United Utilities North West PLC: preference shares	130.0	7.0%	October 2099

The following loans to associated companies existed at 31 March 2013

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

Financial instruments

The following financial instruments with associated companies existed at 31 March 2013

	Fair value £m	Interest rate payable £m	Interest rate receivable £m	Maturity date £m
United Utilities PLC - £400m interest rate swap	10.2	1.84%	LIBOR	March 2015

Dividends paid to associated undertakings

During the year, interim dividends payable to United Utilities North West PLC totalled £223.5 million (2012: £342.0 million). No final dividend has been recommended for 2012/13 (2012: £nil).

Transfer of assets by or to the appointee

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

Notes to the current cost accounts (continued)

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

Services supplied to the company by associated companies

Nature of transaction	Company	Turnover of associate £m	Terms of supply	March 2013 Total value of goods, works or services £m
Functions support	United Utilities PLC	-	Employment costs	22.7
Employment costs	United Utilities PLC	-	Recharge of costs	0.2
Employment costs	United Utilities Group PLC	-	Recharge of costs	0.8
Accommodation	United Utilities Property Services Ltd	13.0	Contract price	0.5

Services supplied by the company to associated companies

Nature of transaction	Company	Turnover of associate £m	Terms of supply	March 2013 Total value of goods, works or services £m
	United Utilities Property Services Ltd	13.0		0.4
	United Utilities Utility Solutions (Industrial) Ltd	0.5		0.4
	United Utilities PLC	-		0.5
Employment cost and travel costs	United Utilities International Ltd	1.1	Recharge of costs	0.3
	United Utilities Group PLC	-		0.5
	United Utilities Water Operations Holdings Ltd	-		0.1
				2.2
Wastewater treatment services	United Utilities Water PLC (non appointed)	2.8	Contract price	1.7
Accommodation	United Utilities Property Services Ltd	13.0	Recharge of costs	2.3
Property Searches	United Utilities Water PLC (non appointed)	2.7	Contract price	0.8

The services provided by United Utilities PLC Functions’ employees (including ICT, HR, Finance, Corporate Affairs and General Counsel) predominantly support UUW. These costs have been incurred directly by United Utilities Water PLC throughout 2012/13 but relate to employees of United Utilities PLC.

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

Notes to the current cost accounts (continued)

8. Reconciliation between statutory accounts and historical cost regulatory accounts

	Statutory (UK GAAP)	Regulatory Total business	Difference	Explanation of differences
	£m	£m	£m	
Profit and loss account				
			30.3	The company has not recognised revenue in the statutory accounts where it does not consider it probable that it will receive payment, in accordance with FRS 5 'Reporting the Substance of Transactions' Application Note G. In the regulatory accounts, revenue is recognised in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name (2012: £32.7 million).
			(3.5)	Income from energy generation, exported energy, renewable obligation certificates and ROC bonuses is treated as turnover in the statutory accounts but as negative operating expenditure in the regulatory accounts (2012: £5.8 million).
Turnover	1,604.7	1,631.5	26.8	
			5.1	The difference in infrastructure renewals accounting has increased the infrastructure renewals charge in the regulatory accounts (2012: £2.5 million increase).
			1.7	The difference in revenue recognition results in an adjustment to turnover net of bad debt charge (2012: £2.6 million).
			(1.3)	In the statutory accounts the company classifies rental income of £1.3 million as operating income (2012: £1.4 million). Ofwat accounting guidelines state that this should be classified as 'other income', i.e. below the operating profit line. Profit before tax is unaffected by this re-classification.
Operating profit	635.3	640.8	5.5	

Notes to the current cost accounts (continued)

8. Reconciliation between statutory accounts and historical cost regulatory accounts (continued)

	Statutory (UK GAAP)	Regulatory Total business	Difference	Explanation of differences
	£m	£m	£m	
			5.1	The difference in infrastructure renewals accounting has decreased the infrastructure renewals charge in the regulatory accounts (2012: £2.5 million increase).
			1.7	The difference in revenue recognition results in an adjustment to turnover net of bad debt charge (2012: £2.6 million)
Profit on ordinary activities before tax	311.4	318.2	6.8	
			(1.2)	Deferred tax charge relating to infrastructure renewals (2012: £(2.1) million).
			(0.4)	Deferred tax charge relating to revenue recognition (2012: £(0.4) million to current tax charge).
			(0.3)	Mainly due to the impact of discounting on the difference in the qualifying NBV between Statutory and Regulatory accounts.
Taxation	(76.8)	(78.7)	(1.9)	

Notes to the current cost accounts (continued)

8. Reconciliation between statutory accounts and historical cost regulatory accounts (continued)

	Statutory (UK GAAP)	Regulatory Total business	Difference	Explanation of differences
	£m	£m	£m	
Balance sheet				
			2.8	In the preparation of the statutory accounts, the company has followed industry practice and applied the infrastructure renewals accounting basis as set out in FRS 15 'Tangible Fixed Assets'. An infrastructure renewals accrual of £2.8 million (2012: £9.3 million) is within fixed assets in the statutory accounts. However, for the purposes of the regulatory accounts, Ofwat has requested that FRS 15 'Tangible Fixed Assets' is not applied for infrastructure renewals accounting. The regulatory accounts include an infrastructure renewals prepayment of £11.0 million (2012: £7.4 million) within other current assets. The difference between the infrastructure renewals accrual in the statutory accounts and infrastructure renewals prepayments in the regulatory accounts arises from the differences in interpretation of infrastructure renewals accounting policies.
			(70.7)	Cumulative value of the statutory to regulatory adjustments, such as the water mains cleaning programme and the DG5 flooding programme (2012: £78.6 million).
Tangible fixed assets (net book value)	8,651.3*	8,583.4*	(67.9)	*Within these totals is £0.6 million (2012: nil) of capitalised development costs which are shown as intangible assets in the statutory accounts.
Short-term deposits	-	40.0	40.0	Loans to group companies are classified in debtors falling due within one year within the statutory accounts.

Notes to the current cost accounts (continued)

8. Reconciliation between statutory accounts and historical cost regulatory accounts (continued)

	Statutory (UK GAAP) £m	Regulatory Total business £m	Difference £m	Explanation of differences
			(40.0)	See above Short-term deposits re: loans to group companies.
			8.1	The difference in revenue recognition policies results in an increase in trade debtors on the regulatory balance sheet (2012: £6.2 million).
			67.4	Amounts relating to measured customers who have credit balances arising from a direct debit plan are shown within debtors in the regulatory accounts, but as creditors in the statutory accounts. (2012: £59.9 million).
Debtors	926.2	961.7*	35.5	*Within £1,036.7 million other current assets.
			130.0	Preference shares are separately disclosed on the face of the regulatory balance sheet whereas they are included within creditors: amounts falling due within one year in the statutory accounts (2012: £130.0 million).
			6.6	In the regulatory accounts, deferred grants are classified within provisions for liabilities and charges, whereas they are included within creditors: amounts falling due within one year in the statutory accounts (2012 £6.4million).
			(67.4)	See above Debtors re: measured customer credit balances.
Creditors: amounts falling due within one year	(745.8)	(676.6)	69.2	
Creditors: amounts falling due after one year	(6,408.9)	(6,336.1)	72.8	In the regulatory accounts, deferred grants are classified within provisions for liabilities and charges, whereas they are included within creditors: amounts falling due after one year in the statutory accounts (2012 £74.4million).
			(79.5)	See above Creditors: amounts falling due within and after one year re: deferred grants (2012: £80.7 million).
			7.7	Cumulative effect of the above items on the deferred tax provision (2012: £9.5 million).
Provisions for liabilities and charges	(404.2)	(476.0)	(71.8)	
Preference share capital	-	(130.0)	(130.0)	See above Creditors: amounts falling due within one year re: preference shares (2012: £130.0 million).

Notes to the current cost accounts (continued)

9. Statement of directors' remuneration and standards of performance

During the year ended 31 March 2013, remuneration has been paid by the company to the directors as a result of arrangements linking directors' remuneration to levels of performance against service standards in connection with activities subject to price regulation.

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

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

The UUW executive directors participate in the United Utilities bonus scheme and in UUG PLC share based long-term incentive schemes (Performance Share Plan and Matching Share Award Plan) as documented in the UUG 2013 Annual Report and Financial Statements. Through the schemes the executive directors can receive remuneration linked to the achievement of performance measures which relate to water service standards in order to provide an incentive for them to deliver improvements in those standards.

In determining the outcome of the incentive schemes, standards of performance are assessed by the UUG PLC Remuneration Committee (the Committee) to ascertain whether targets have been achieved. In addition, the Committee also considers relevant reports from Ofwat in assessing the achievement of standards of performance.

2012/13 bonus scheme

As part of the 2012/13 bonus scheme, performance was assessed against the following water service measures which were regularly monitored on a UUW scorecard, and accounted for 90 per cent of their maximum bonus opportunity:

Scorecard measure	Achievement in 2012/13
Underlying operating profit	Partially met target
Regulatory capital expenditure (spend)	Achieved target
Regulatory capital expenditure (outputs)	Achieved target
Customer service (Service Incentive Mechanism)	Partially met target
Serviceability	Achieved target
Corporate responsibility	Achieved target

For all of these bonus measures there was a threshold level of performance which triggered a partial payment of bonus with a sliding scale providing for achievement of up to 100 per cent of the relevant element of bonus. In 2012/13 each of the UUW scorecard measures listed above achieved at least the threshold level of performance.

Details of the bonus payments made for the UUW PLC directors in respect of the above bonus measures for the year ended 31 March 2013 are as follows:

Director	Bonus re: UUW scorecard targets
SL Mogford (1)	£646,164
JR Houlden (1)	£407,708

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

Both directors were required to defer 50 per cent of their bonus into UUG PLC shares for three years under a new Deferred Bonus Plan (DBP).

Notes to the current cost accounts (continued)

9. Statement of directors’ remuneration and standards of performance (continued)

2010 long-term incentive scheme: Performance Share Plan (PSP)

The long-term incentive schemes commence at the start of each financial year and incentivise the achievement of specific standards of performance on a number of measures over a three-year performance period. The three-year performance period for the 2010 PSP ended on 31 March 2013. JR Houlden was a participant in this scheme but SL Mogford was not.

37.5 per cent of the award was assessed against the following water service measure:

Performance measure	Achievement in 2012/13
Relative efficiency and operational expenditure outperformance	Partially met target

For this performance measure there were threshold, intermediate and stretch targets. The intermediate level of performance was achieved.

Details of the UUG PLC shares received by the UUW PLC directors in respect of the PSP measures which related to water service standards are as follows:

Director	Shares re: UUW scorecard targets
JR Houlden	10,401 shares valued at £81,856(1)

(1) Based on a UUG PLC share price of 787p as at the vesting date on 21 May 2013.

Clawback and malus provisions

Bonuses and PSP awards are subject to clawback provisions in the event of a material overstatement in the financial statements of UUG PLC arising from fraud or error.

Furthermore, under the rules of the new DBP, the Committee will have the discretion to reduce the number of unvested shares, cancel an award or impose further conditions on an award, in such negative circumstances it considers such action is appropriate. This would include circumstances such as material misstatement of audited financial results, serious failure of risk management, or serious reputational damage.

A description of the other elements of the executive directors’ remuneration is given in the 2013 Annual Report and Financial Statements of UUG PLC. For the forthcoming year, the UUG PLC incentive arrangements will continue to reflect the importance of achieving service standards. Performance will again be assessed against the same key measures including serviceability and Service Incentive Mechanism (SIM) scores, which are routinely used by Ofwat to assess standards of company performance.

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

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

Supplementary regulatory information

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

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

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

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

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

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

- the financial position of the business at 31 March 2013 as represented by the statutory and regulatory accounts;
- projected cash flows as represented by the business plan and budget, treasury funding plan and estimated investment and operational requirements for the Regulated Activities;
- the anticipated managerial resources available; and
- the contract provisions with associated companies.

Certified as having been approved at a duly convened meeting of a committee of the board of Directors of United Utilities Water PLC held on 4 June 2013.

JR Houlden

Director

4 June 2013

Supplementary regulatory information (continued)

CERTIFICATE UNDER PARAGRAPH 3.1 OF CONDITION K OF THE APPOINTMENTS

As required in paragraph 3.1 of Condition K of the Licence, the directors state that as at 31 March 2013, had a special administration order been made under Section 23 of the Water Industry Act 1991 in respect of the company, the company would have had available, in their opinion, sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company.

Certified as having been approved at a duly convened meeting of a committee of the board of Directors of United Utilities Water PLC held on 4 June 2013.

JR Houlden

Director

4 June 2013

Supplementary regulatory information (continued)

Appendix 1 – Upstream Services Data for the 12 months ended 31 March 2013 (Unaudited)

Service analysis – Water

	Water resources £m	Raw water distribution £m	Water treatment £m	Treated water distribution £m
Total operating expenditure	54.2	11.8	62.7	74.5
Infrastructure renewals charge	17.7	0.9	-	53.2
Current cost depreciation	15.8	2.4	62.5	72.6
Total operating costs	87.7	15.1	125.2	200.3

	Abstraction licence £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Trunk treated water distribution £m	Local water distribution £m
Total operating expenditure	19.8	34.4	11.8	-	62.7	45.1	29.4
Infrastructure renewals charge	-	17.7	0.9	-	-	8.0	45.2
Current cost depreciation	-	15.8	1.9	0.5	62.5	44.0	28.6
Total operating costs	19.8	67.9	14.6	0.5	125.2	97.1	103.2

Service analysis – Sewerage

	Sewage collection £m	Sewage treatment[1] £m	Sludge treatment[1] £m	Sludge disposal £m
Total operating expenditure	44.9	100.9	31.2	22.7
Infrastructure renewals charge	74.4	1.3	2.0	-
Current cost depreciation	34.3	172.5	42.5	1.6
Total operating costs	153.6	274.7	75.7	24.3

	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal[1] £m	Sludge transport £m	Sludge treatment £m	Liquor treatment distribution[1] £m	Sludge disposal £m
Total operating expenditure	28.3	9.9	6.7	100.9	4.5	25.6	1.1	22.7
Infrastructure renewals charge	73.6	-	0.8	1.3	2.0	-	-	-
Current cost depreciation	21.6	7.5	5.2	164.6	0.6	40.1	9.7	1.6
Total operating costs	123.5	17.4	12.7	266.8	7.1	65.7	10.8	24.3

[1] –In accordance with Information Notice 13/01 'Revised regulatory accounting guidelines and regulatory accounts reporting for 2012-13 onwards', in the regulatory accounts, assets are recorded in the business unit of principal use. However, for the upstream service analysis table, depreciation has been allocated across services based on usage. Where assets are used for services in different business units this can result in reallocations across business units. They key reallocation in the upstream services table relates to liquor treatment at sewage treatment works, whereby depreciation of £7.9 million has been allocated to liquor treatment.

Supplementary regulatory information (continued)

Appendix 2 Non financial information for the 12 months ended 31 March (Unaudited)

	2013		2012	
	Water	Sewerage	Water	Sewerage
Number of properties (000s)				
Households billed	2,863.2	2,837.1	2,854.7	2,829.0
Non-households billed	172.9	182.8	173.1	183.0
Households voids	159.5	158.7	158.1	157.1
Non-households voids	25.0	45.5	25.7	45.6
Properties served by new appointee in supply area as at 1 April 2009	-	-	-	-
Per capita consumption (excluding supply pipe leakage l/h/d)				
Unmeasured household	138.6	-	141.9	-
Measured household	104.7	-	107.9	-
Volume (Ml/d)				
Bulk supply export	18.6	0.2	18.9	0.2
Bulk supply import	0.7	-	0.7	-
Distribution input	1,715.3	-	1,739.2	-