



# United Utilities Group PLC

Annual Report and Financial Statements  
for the year ended 31 March 2017

# Welcome to our Annual Report and Financial Statements for the year ended 31 March 2017

As the UK's largest listed water company, we help life flow smoothly for around seven million people and 200,000 businesses in the North West by providing them with clean, fresh water every day.

We take away and treat the North West's wastewater, helping to keep our rivers and beaches clean.

Across our region, we are investing to make our network more resilient to the effects of climate change and to continue to improve drinking water quality.

We want to ensure that our customers can rely on us for a great service, and that the investment we are making to deliver this gives a boost to the North West's economy, supporting thousands of jobs, and securing a legacy for the future.

**Our vision is to be the best UK water and wastewater company, providing great service to our customers.**



Read more information on [How we create value](#) on page 12



You can read more in our online Annual Report at [unitedutilities.com/corporate](http://unitedutilities.com/corporate) where we maintain a wide range of information of interest to institutional and private investors including:

- › latest news and press releases;
- › reports and publications; and
- › corporate responsibility content.

**Front cover:** We have adopted an innovative systems-based approach to our regional water system and wastewater drainage areas which we call Systems Thinking. You can read more about this on page 30 or watch our short video on the home page of [unitedutilities.annualreport2017.com](http://unitedutilities.annualreport2017.com)

## What's in this report



How we create value  
p 12



Our performance in 2016/17  
p 34



Read about our board of directors  
p 52



Read our remuneration report  
p 86



Financial statements  
p 119



Key dates for 2017  
p 174

Our Annual Report and Financial Statements aims to meet the information needs of our investors to help them make informed decisions regarding their participation – for example, whether to buy, sell or hold our shares or bonds, whether to engage with management on issues and how to vote their shares. This includes information that we believe is material to these decisions and we present it in a way which we believe is fair, balanced and understandable.

We recognise that this report will be read by a wide variety of other stakeholders including customers, suppliers, analysts, regulators, non-governmental organisations, politicians and devolved authorities. Where we believe that a topic is material to a large number of them, we either include it in this report or refer to other reports and information (such as our customer communications, our corporate responsibility web pages or our regulatory reports).

We believe this approach meets the requirements of company law, the UK Corporate Governance Code, IFRS and the <IR> Framework and that we go beyond those requirements where we feel it is particularly helpful to do so and where that can be done without making the report unnecessarily lengthy or difficult to read.

### Integrated report

We continually seek to develop our integrated reporting, building on enhancements made in prior years, in order to improve our communication with stakeholders.

This annual report has been prepared and presented in accordance with the International <IR> Framework published by the International Integrated Reporting Council in December 2013 and approved by the board.

## Contents

Chairman and Chief Executive Officer's review	02
2016/17 highlights	06

### Strategic Report

<b>What we do</b>	
Where we operate	10
Our water cycle	11
Our industry and market	11
<b>How we create value</b>	
Our vision	12
Our core values	12
Our business principles	12
Our strategy	12
Our competitive advantage	13
Our business model	14
How we engage with our stakeholders	15
Key resources	16
External environment	18
Internal environment	24
Planning cycles	26
Systems Thinking	30
<b>How we measure our performance</b>	
Strategic themes and outcomes	31
Our key performance indicators (KPIs)	31
Operational KPIs	32
Financial KPIs	33
Our performance in 2016/17	
Operational performance	34
Financial performance	40
<b>How we manage risk</b>	46

### Governance

Corporate governance report	
Board of directors	52
Letter from the Chairman	56
Nomination committee report	66
Audit committee report	74
Corporate responsibility committee report	82
Remuneration committee report	86
Tax policies and objectives	110
Directors' report	111
Statement of directors' responsibilities	117

### Financial Statements

Independent auditor's report	120
Consolidated income statement	124
Consolidated statement of comprehensive income	125
Consolidated and company statements of financial position	126
Consolidated statement of changes in equity	127
Company statement of changes in equity	128
Consolidated and company statements of cash flows	129
Guide to detailed financial statements disclosures	130
Accounting policies	131
Notes to the financial statements	134
Five-year summary – unaudited	172

### Shareholder Information 174

# Chairman and Chief Executive Officer's review

We are on track to deliver our vision of becoming the UK's best water and wastewater company, providing great service to our customers and creating value for our shareholders.

## Overview

We have continued to improve performance for shareholders, customers and the environment as we aim to deliver further value and sustainable dividends backed by a strong balance sheet. Our performance in the early part of this regulatory period puts us in an industry leading position. The acceleration of our capital investment programme is delivering the benefits of operational efficiencies early and this is being reflected in our Outcome Delivery Incentive (ODI) performance where we have achieved another positive net outcome for the year. Our overall performance against our regulatory contract gives us confidence to invest an additional £100 million in projects to improve resilience over the next three years for the benefit of customers. Our Systems Thinking approach is unparalleled in the sector and on track to deliver £100 million of savings across the 2015-20 regulatory period, underpinning our business plan. In addition, we have seen a step change in customer service, delivering our best ever customer satisfaction scores.

## Customer focus

The business has undergone a key cultural shift in recent years so that customer service sits at the core of everything we do. Having significantly improved customers' experience of our services over the last regulatory period, in which we became one of the most improved companies under our regulator Ofwat's Service Incentive Mechanism (SIM), we were determined to re-energise our approach to deliver an even better customer experience.

Our new customer service team was formed at the beginning of this year and set about benchmarking our performance both in and outside the sector. From this we identified a range of opportunities to improve customer satisfaction and reach out to customers struggling to pay.

Over the year, we have seen sustained improvement of our customer satisfaction scores under Ofwat's new SIM measure for this regulatory period, ending the year as one of the leading companies in our peer group. We are particularly pleased to have introduced a number of innovations that set new benchmarks for the sector.

One of our most successful innovations, Priority Services, was launched during the year. It provides dedicated support for those customers who are experiencing short or long-term personal challenges in their lives, such as physical or mental health difficulties, as well as those struggling financially.

Priority Services encompasses the wide range of initiatives we already have in place to help customers return to regular payment and adds tailored assistance to those customers with more specialised needs. We were delighted to see, over the course of the year, how well it has been received by customers, with 30,000 customers now registered.

Notwithstanding our benchmark debt management processes and wide range of schemes to help customers struggling to pay, as our region suffers from high levels of income deprivation, bad debt and cash collection will remain a principal challenge for us. Our new team has made further inroads in this area, reducing household bad debt to 2.5 per cent in 2016/17 from 3.0 per cent in the previous year.

One new innovation contributing to this success is a targeted campaign, which we call Town Action Planning, where we visit customers in areas where deprivation is particularly high. The scheme is proving particularly successful in engaging with hard to reach customers, helping them understand our various support schemes and payment options to find the arrangement most suited to their circumstances. In addition, we have been able to identify customers eligible for Priority Services who would otherwise have been unknown to us.

We recently introduced our new customer website, with a very different look and feel, developed following extensive research, which aims to deliver improved accessibility and ease of use. Mobile-enabled, the website reflects customers' increasing use of devices to access day-to-day online services, and offers web chat services across extended hours. This is the first phase of our digital transformation, aimed at helping customers' lives flow a little more smoothly.

Ended the year as a leading company in our peer group for customer satisfaction

Systems Thinking and innovation delivering ODI performance ahead of expectations

Additional £100m of new investment to improve resilience as outperformance earned



**Pictured:** Dr John McAdam, Chairman and Steve Mogford, Chief Executive Officer at our wastewater treatment works in Liverpool.

## Financial performance

Group revenue was slightly lower than last year, reflecting the accounting impact of our Water Plus joint venture (JV) as we prepared ourselves for the opening of competition in the non-household retail market on 1 April 2017, partly offset by our allowed regulatory revenue changes.

Underlying operating profit was up £19 million, at £623 million. This reflects the new regulated price controls, slightly lower infrastructure renewals expenditure, only a marginal increase in depreciation (as we recognised some accelerations in depreciation last year) and a small decrease in the remaining cost base, partly offset by the accounting impact of our Water Plus JV. Reported operating profit was £606 million, up £38 million, mainly as a result of reduced profit last year which was principally due to costs associated with our water quality incident in Lancashire.

Underlying profit before tax was down £19 million to £389 million, as the £19 million increase in underlying operating profit was more than offset by a £36 million increase in underlying net finance expense. The increase in underlying net finance expense is mainly due to the impact of higher RPI inflation on our index-linked debt. Reported profit before tax was £442 million, up £89 million on the previous year, reflecting fair value gains on our debt and derivative instruments this year, versus fair value losses last year, along with other adjusting items as outlined in the underlying profit measures table on pages 44 to 45.

Underlying earnings per share was 46.0 pence, more than covering the dividend. Reported earnings per share was higher at 63.6 pence, mainly reflecting a deferred tax credit as a result of the UK Government's future planned reduction in the mainstream rate of corporation tax.

The board is proposing a final dividend of 25.92 pence per ordinary share, making a total of 38.87 pence per ordinary share for the 2016/17 financial year. This represents an increase of 1.1 per cent, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

We have a robust capital structure, supported by our policy of targeting a gearing level, measured as net debt to regulatory capital value, within the range of 55 per cent to 65 per cent. We aim to maintain, as a minimum, our existing credit ratings of A3 with Moody's and BBB+ with Standard & Poor's for United Utilities Water Limited. This helps us retain efficient access to the debt capital markets throughout the economic cycle, and we have debt locked in at attractive rates versus Ofwat's cost of debt for the 2015-20 period.

Our pension scheme asset-liability matching approach has proven its effectiveness, providing us with stability in a time of turbulent market conditions this year and protecting us from the pension headwinds hurting much of the FTSE. Our pensions position remains strong and we had an IAS 19 surplus of £248 million at the 2016/17 financial year end.

## Operational performance

We began this 2015-2020 regulatory period with ODIs, set by Ofwat, reflecting an increasingly challenging set of performance targets. The ODIs are skewed heavily towards penalty, so we took the decision in the first year of the period to accelerate our capital investment programme to deliver operational performance improvements as soon as possible with the aim of mitigating the downside risks represented by the ODIs.

This acceleration has continued in year two, with a further £804 million invested, similar to last year, so that at the end of this year we had invested around £1.6 billion of our total c£3.6 billion capital programme for the five years. This programme is providing for infrastructure renewals in addition to delivering enhanced environmental performance, climate change resilience initiatives and customer service improvements.

# Chairman and Chief Executive Officer's review

We are delighted that this strategy is paying off with another year in which we delivered a small ODI reward of £6.7 million, improving again from the first year of the period. This reflects a considerable achievement by our operational teams to maintain sector leading performance across our asset base as new capability is progressively delivered through accelerated investment, particularly in our wastewater business.

It is important that we invest effectively, particularly where we are accelerating spend, and we use our Time, Cost and Quality index (TCQI) to measure performance in this area. Our capital team continues to deliver effectively with TCQI again scoring high at c93 per cent for the year.

## Systems Thinking

Our integrated approach to delivery of services to customers, Systems Thinking, continues to progressively improve our operational capability across the business. For instance, our new telemetry backbone provides enhanced and more reliable communications between our assets and our integrated control centre, with the potential to share more information between the two as our capabilities grow.

In addition, our real-time production capability for both water production and sludge processing is delivering efficiency benefits and flexibility during planned shutdowns and incidents, significantly improving system resilience during difficult periods. We rolled out our new field scheduling system during this year in pilot areas and we are now embracing that learning before rolling out this capability across our estate.

## Performance against our regulatory contract

Having successfully locked in a low cost of debt, we feel we are in a strong position to deliver our target for the 2015-20 period of beating Ofwat's industry allowed cost of debt. We are making good progress in implementing a range of initiatives, to deliver over £400 million of savings and remain confident of meeting our totex allowance.

We are pleased to see continued strong performance in the areas of private sewers and pollution incidents, as well as good performance against our leakage targets. Following a good performance on our ODIs in 2015/16, the £6.7 million achieved this year brings our cumulative total to £9.2 million, which helps to limit our downside risk for the regulatory period. Whilst a number of our ODI measures are still susceptible to one-off events and, on the whole, they get tougher each year, our performance so far gives us the confidence to narrow our cumulative target range to between a £30 million net reward and a £50 million net penalty, across the five-year period.

As part of our responsible approach to resilience, and based on outperformance we have earned to date, we aim to make around £100 million available for additional investment across this regulatory period to deliver significant resilience benefits. The first £20 million will be made available in the next financial year, with the remaining investment phased over the rest of this regulatory period.

## Retail competition for non-household customers

For a number of years, we have been building capability to ensure we were in a strong position ahead of the full opening of the non-household retail market in April of this year. With our Water Plus joint venture with Severn Trent up and running, this reinforces our position and gives us a first-mover advantage.

Combining the complementary skills of both companies gives Water Plus scope to deliver an attractive proposition for customers, as well as creating synergies to provide an efficient and cost-effective operation focused on improved customer service and growth.

Since going live with the joint venture in June 2016, the business has relocated to Stoke-on-Trent, migrated all customers into a single cloud-based billing system, recruited over 300 people and ensured all systems were fully market ready.

## Long-term planning

In order to maintain a reliable, high quality water service for our customers, we have to look a long way ahead and anticipate those changes and core issues that are likely to impact on our activities. Our long-term strategy helps us define what we need to deliver over the shorter term, which in turn helps to create value. In the next 25 years, we will face many challenges and opportunities including climate change and its implications for water resources and flooding, the emergence of a more open, competitive UK water market, more rigorous environmental regulations and the ever-present need to combine affordable bills with a modern, responsive water and wastewater service.

By anticipating these changes we can ensure we continue to deliver what customers want at a fair price and in a responsible way. Our 25-year Water Resource Management Plan sets out the investment needed to ensure we have sufficient water to continue supplying our customers, taking into account the potential impact of climate change.

An example of a large project we are currently undertaking, to address future supply and demand issues for customers, is our 100 kilometre Thirlmere pipeline project, which will extend our integrated network to encompass West Cumbria. This will provide a secure, long-term supply for the area and ease pressure on environmentally sensitive local water resources. The pipeline will cross some of the most special areas of the Lake District National Park and, as a result, we have developed a solution which respects this sensitivity whilst delivering the lowest whole-life cost. The project demands the highest levels of stakeholder engagement and consultation to secure support, and we have been engaging with local communities on the proposed route since 2013. We were particularly pleased last autumn to receive the third and final planning approval for this project.

## Water 2020

Ofwat is progressing a number of options for the next price review, which spans the period 2020-25, including competition in water resources and bio-processing (or sludge), along with the progressive transition from RPI to CPI inflation. We have continued to engage proactively and constructively with the regulators and the industry over the last year, and have submitted comprehensive responses to Ofwat's various consultation papers.

In water resources, competition will apply to new resources only and our long-term water resources management plan indicates that our region is unlikely to need any new resources for many years. We will continue to engage strongly in regulatory developments, with customers and shareholders at the forefront of our thinking.

## Our employees

Our people are fundamental to the improvements we have delivered in operational performance and customer service. We are proud of their commitment and dedication. Employee engagement remains at high levels, demonstrating that our employees have a strong capability to adapt and we would like to thank them for their critical contribution to the company's performance.

We have been successful in attracting and retaining people, having regenerated our graduate and apprentice schemes in 2010 and continuing to expand them over seven years to help provide an optimal balance of skills and experience within the group.

In the first year of our apprentice scheme in 2010 we took on six apprentices, and have built this intake to 54 apprentices in 2016, taking our total programme to 119 apprentices currently employed. We are accredited by four awarding bodies and named as one of the top 100 apprenticeship employers.

We have 64 people currently on our graduate scheme, across a range of different disciplines, including finance, engineering, commercial and project management. We encourage diversity among the new generation we are bringing into this industry and c40 per cent of our current graduates are female.

We are committed to helping local schools and have 47 trained Science, Technology, Engineering and Mathematics (STEM) ambassadors. We frequently attend careers events across our region and have good links with local universities. In March 2017, we formally launched a partnership with Teach First, a charity which strives to end educational inequality by placing and training graduates to teach in low income communities. This partnership will help with our desire to be more active with schoolchildren in communities that are hard to reach within our region, by helping them to improve their employability skills, raising awareness of future career opportunities and offering our employees development opportunities in coaching and mentoring Teach First teachers and students.

Despite continuing with a sustained focus on health, safety and wellbeing, our employee accident frequency rate for 2016/17 has increased to 0.196 accidents per 100,000 hours, compared with a rate of 0.104 in 2015/16. However, as part of our health and safety improvement programme, we have implemented several initiatives and over the same period we have been awarded the workplace wellbeing charter and retained RoSPA gold status. We recognise that we still have more to do, so health and safety will continue to be a significant area of focus for us.

## Strong corporate responsibility credentials

We operate in a manner that aims to deliver the highest levels of corporate governance and our board continues to provide sound and prudent governance, consistent with the principles of the UK Corporate Governance Code.

In the summer of 2016, we were pleased to, once again, attain Industry Leading company status, as measured through the Environment Agency's (EA) annual assessment. In particular, we delivered another strong performance in the area of pollution, and were one of only two companies to attain a Green rating for serious pollution incidents.

We have consistently met, or outperformed, our regulatory leakage targets and our performance to date keeps us on track to meet our 2015-20 targets, as set by Ofwat. We are committed to reducing our carbon footprint and increasing our generation of renewable energy. We have reduced our carbon footprint by 22 per cent over the last 10 years and progress in 2016/17 has been encouraging, with a high proportion of our waste used in regeneration projects and less than 6 per cent sent to landfill in 2016/17.

Our strong corporate responsibility and environmental credentials were recognised this year when we retained World Class rating in the Dow Jones Sustainability Index for the ninth consecutive year, an achievement we are particularly proud of in light of the ever-evolving standards.

In addition, at the Finance for the Future Awards in October 2016, we were honoured to win the Communicating Integrated Thinking award, an international award sponsored by Deloitte, Accounting for Sustainability and the Institute of Chartered Accountants in England and Wales.

## Outlook

We are encouraged by our continued strong operational and environmental performance, as well as our improvements in customer satisfaction. We have plans to improve further, supported by our Systems Thinking approach to operating the business, and the acceleration of our capital investment programme. Overall, we are encouraged by our progress, in the early part of this regulatory period, and are confident that we can deliver our targets for both customers and shareholders. We continue to deliver sustainable dividend growth, with an annual growth target of at least RPI inflation through to 2020, supported by a robust financial position.

Finally, we would like to thank our employees, customers and wider stakeholders for their continued support.



**Dr John McAdam**  
Chairman



**Steve Mogford**  
Chief Executive Officer

The strategic report on pages 10 to 49 was approved at a meeting of the board on 24 May 2017 and signed off on its behalf by Steve Mogford, Chief Executive Officer.

# 2016/17 highlights

## Operational highlights

Our planned acceleration of investment and Systems Thinking approach has successfully delivered operational benefits and now helped us to achieve Outcome Delivery Incentive (ODI) rewards in the first two years of this five-year regulatory period. Alongside this, our new customer service management team is delivering further improvements in customer satisfaction, which saw us end the year as one of the leading companies in our peer group for Service Incentive Mechanism (SIM) scores, with record SIM scores across a range of areas throughout the year and our customers continuing to rate us highly on billing and wastewater services.

### The best service to customers

#### A leading company for Service Incentive Mechanism (SIM) scores

- › Re-energised our approach, delivering further improvements in customer satisfaction
- › Achieved our best ever qualitative SIM scores, above industry average for the full year, and ending the year as a leading company in the sector
- › Customer complaints reduced 27 per cent, with a 55 per cent reduction in issues not resolved at first contact

#### Accelerated investment delivering operational and customer benefits

- › Improving resilience of our network
- › Delivered another net ODI reward of £6.7 million, giving us confidence to refine our ODI target range further to a £30 million reward to a £50 million penalty over the 2015-20 period
- › Effective and efficient delivery of capital programme, with TCQI score remaining high at 93 per cent



**Pictured:** We've undertaken a series of roadshows across the North West to speak to customers about our Priority Services.

### At the lowest sustainable cost

#### Delivering or exceeding our targets

- › Remain on track to meet our totex allowance
- › Outperformed Ofwat's revenue allowance on household retail cost to serve despite challenging targets
- › Low cost of debt locked-in places us in a strong position to deliver our target of beating Ofwat's industry allowed cost of debt

#### Systems Thinking driving improved operational performance, resilience and innovation

- › Design for Manufacture and Assembly (DfMA) innovative approach
- › On track to deliver the £100 million of totex savings across the regulatory period underpinning our business plan

#### Solid financial performance

- › Underlying operating profit up 3 per cent
- › Effective pensions hedging protecting us from volatile market conditions



**Pictured:** Storm overflow pipes travelling from Norway to Anchorsholme to be used as part of our bathing water quality programme.

### In a responsible manner

#### Excellent Environmental, Social and Governance (ESG) credentials

- › Industry Leading status in the Environment Agency's assessment, and one of only two companies to attain Green rating for serious pollution incidents
- › Retained World Class rating in Dow Jones Sustainability Index for ninth consecutive year

#### Launched Priority Services

- › Offering dedicated support for customers experiencing short or long-term personal or financial challenges

#### Additional investment to improve resilience

- › £100 million additional investment across this regulatory period as outperformance is earned
- › First £20 million being made available in 2017/18, with the remaining investment to be phased over the next two years of this regulatory period



**Pictured:** Floating solar panels at Godley Reservoir, Greater Manchester producing renewable energy.

 Read more about how we performed against our [Operational KPIs](#) on page 32

 Read more about our [Operational performance](#) on pages 34 to 39

## Financial highlights

We delivered a solid performance with underlying operating profit up 3 per cent. We have a robust capital structure and effective pensions hedging policy in place, protecting us from the headwinds of turbulent market conditions. We delivered a net reward on our ODIs and improved bad debt performance in a challenging environment. We have now delivered seven years of sustainable dividend growth of at least RPI inflation, increasing our total dividend this year by 1.1 per cent in line with our policy.

### Revenue

<b>16/17</b>	<b>£1,704m</b>
15/16	£1,730m
14/15	£1,720m
13/14	£1,689m
12/13	£1,636m

Revenue was down £26 million at £1,704 million, reflecting the accounting impact of our Water Plus JV, which completed on 1 June 2016, partly offset by our allowed regulatory revenue changes.

### Underlying operating profit\*

<b>16/17</b>	<b>£622.9m</b>
15/16	£604.1m
14/15	£664.3m
13/14	£634.6m
12/13	£604.2m

Underlying operating profit was higher by £19 million, at £622.9 million, reflecting the new regulatory price controls, a reduction in infrastructure renewals expenditure and lower total costs, offset by the accounting impact of our Water Plus JV.

### Reported operating profit\*

<b>16/17</b>	<b>£605.5m</b>
15/16	£567.9m
14/15	£653.3m
13/14	£636.9m
12/13	£601.6m

Reported operating profit was higher by £38 million, at £605.5 million, reflecting the £19 million increase in underlying operating profit for the reasons detailed above, as well as reduced profit last year due to costs associated with the water quality incident.

### Total dividend per share

<b>16/17</b>	<b>38.87p</b>
15/16	38.45p
14/15	37.7p
13/14	36.04p
12/13	34.32p

Total dividend per ordinary share for 2016/17 of 38.87 pence. This is an increase of 1.1 per cent on last year, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

\*A guide to alternative performance measures and a reconciliation between underlying operating profit and reported operating profit is shown on pages 44 to 45.



Read more about how we performed against our [Financial KPIs](#) on page 33



Read more about our [Financial performance](#) on pages 40 to 43



**Delivering  
our strategy**

# Strategic Report

The strategic report details our performance over the past year and how it has been achieved in line with our business model and strategy.

<b>What we do</b>	
Where we operate	10
Our water cycle	11
Our industry and market	11
<b>How we create value</b>	
Our vision	12
Our core values	12
Our business principles	12
Our strategy	12
Our competitive advantage	13
Our business model	14
How we engage with our stakeholders	15
Key resources	16
External environment	18
Internal environment	24
Planning cycles	26
Systems Thinking	30
<b>How we measure our performance</b>	
Strategic themes and outcomes	31
Our key performance indicators (KPIs)	31
Operational KPIs	32
Financial KPIs	33
Our performance in 2016/17	
Operational performance	34
Financial performance	40
<b>How we manage risk</b>	46

# What we do

“We’re proud to help life flow smoothly in the North West.”



## Where we operate

From Crewe to Carlisle, our offices and water and wastewater treatment works span the North West of England.

We gather our water from a range of different sources, but predominantly from our reservoirs in the Pennines and the Lake District. We extract water from Lake Vyrnwy in Wales for customers in Merseyside and Cheshire, while the rest is taken from the River Dee, boreholes and streams.

Of the 1,700 million litres we supply every day, well over half is from Cumbria and Wales. The two biggest reservoirs are Thirlmere and Haweswater in Cumbria. Haweswater holds more than 84,800 million litres of water – equivalent to around 33,900 Olympic swimming pools.

We own and manage over 56,000 hectares of land, making us the largest corporate landowner in England.

Much of this is catchment land (the areas immediately surrounding our reservoirs). We recognise that quality control starts right at the point of collection, so we keep our catchment land as clean and sustainable as we can. This helps with the water quality for our customers and makes a huge difference to the environment.

We help to protect over 400km of coastline and around 7,000km of rivers flowing across our region.

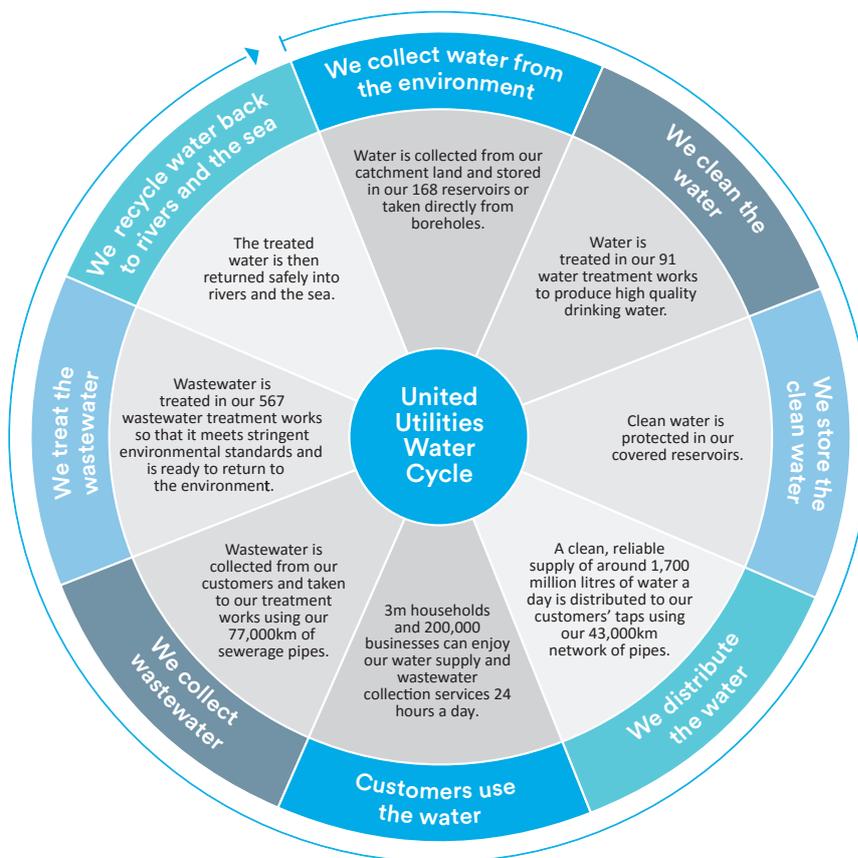
## Our water cycle

The collection, treatment, use and return of water to the environment is naturally a cyclical process.

We collect water from the environment, which we clean and store before distributing it to our customers for their use.

We then collect it as wastewater and treat it before returning clean water back to the environment.

The stages of this water cycle and our involvement in each of these can be seen in the chart to the right.



## Our industry and market

Every day, over 50 million household and non-household customers in England and Wales receive water and wastewater services. These customers are served by 10 licensed companies which are split regionally based on river catchment areas.

United Utilities Water Limited holds licences to provide water and wastewater services to a population of approximately 7 million people in the North West of England.

We provide services to approximately 3 million households, and this generates around two-thirds of our total revenue. We also serve approximately 200,000 businesses, ranging in size from large manufacturing companies to small shops.

We, along with the other nine water and wastewater companies, comprise the vast majority of the total water and wastewater sector, as depicted on the pie chart to the left.

The remainder is made up of 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, 28 years ago, has been widely perceived as a success, making a significant contribution to public health as a result of over £100 billion investment in maintaining and improving assets and services since 1989.

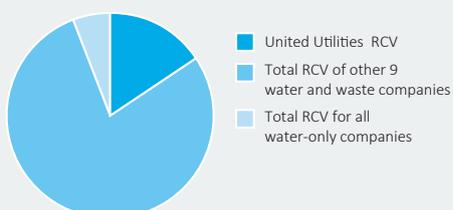
It has led to improvements in the quality of services, higher environmental standards, and superior quality drinking water, at lower estimated costs to customers, than if the water sector was still owned by the UK Government.

In order to protect the interests of customers and the environment, at privatisation, three separate bodies were set up to regulate the activities of water and wastewater companies under the areas of economic, drinking water quality, and environmental regulation. This has evolved to fit with the tightening of laws and regulations over time.

 Read more about our [Political and regulatory environment](#) on pages 20 and 21

## Industry constitution

We are the second largest of the 10 licensed water and wastewater companies, based on the size of our asset base, as measured by Regulatory Capital Value (RCV).



# How we create value

**Our vision is to be the best UK water and wastewater company, providing great service to our customers.**

## Our core values

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

Customer focus	Integrity	Innovation
Everything that we do will be about our customers, not us.	We will make promises knowingly and keep them.	We will innovate to make our services better, safer, faster and cheaper for our customers.

Through our core values, we are embedding a customer service orientated culture, recognising the importance of maintaining a relationship built on trust and confidence, and continually striving to improve the customer experience.

 Read more about our [Values and culture](#) in our Governance section on page 65

## Our business principles

We strongly believe that only by talking and listening to our customers and stakeholders can we act more responsibly and improve the way we do things.

 Read more about our [How we engage with our stakeholders](#) on page 15

With this in mind, we developed a set of business principles through conversations with our customers and stakeholders that demonstrate our commitment to delivering our services in an environmentally sustainable, economically beneficial and socially responsible manner.

These business principles cover five key themes:



More about business principles can be found on our website at: [corporate.unitedutilities.com/united-utilities-business-principles](https://corporate.unitedutilities.com/united-utilities-business-principles)

## Our strategy

Our strategy is to create sustainable value by delivering:



These three strategic themes are used as a framework for us to measure each aspect of our performance, and each of our operational KPIs is closely linked to one of these strategic themes, although it is indicative of the interconnectivity of our business that these may often link broadly to more than one of these strategic themes.

 Read more about our [Operational KPIs](#) on page 32

With our core values and business principles in mind, to demonstrate how we will deliver our strategy with a focus on what our customers and stakeholders want, we have broken down our three strategic themes into eight key outcomes, as set out in our business model.

 Read more about our [Strategic themes and outcomes](#) on page 31

# Our competitive advantage

## How we offer value

The following are key features that we believe make us attractive to investors, alongside the specific differentiating factors described below.

 <p>Clarity on allowed returns through to 2020, with a track record of regulatory outperformance</p>	 <p>Wholesale revenue and asset base linked to RPI inflation to at least 2020</p>	 <p>Sustainable dividend policy, targeting a growth rate of no less than RPI inflation per annum to at least 2020</p>	 <p>Robust capital structure: stable A3 credit rating</p>
 <p>Planning for the long-term, protecting and delivering essential services</p>	 <p>Significant improvements in customer service and operational performance, with more to come</p>	 <p>Customer and environmental benefits delivered through substantial capital investment, driving long-term RCV growth</p>	 <p>Deeply integrated with the environment, with external recognition for our responsible business credentials</p>

## How we differentiate ourselves from our competitors within the water industry

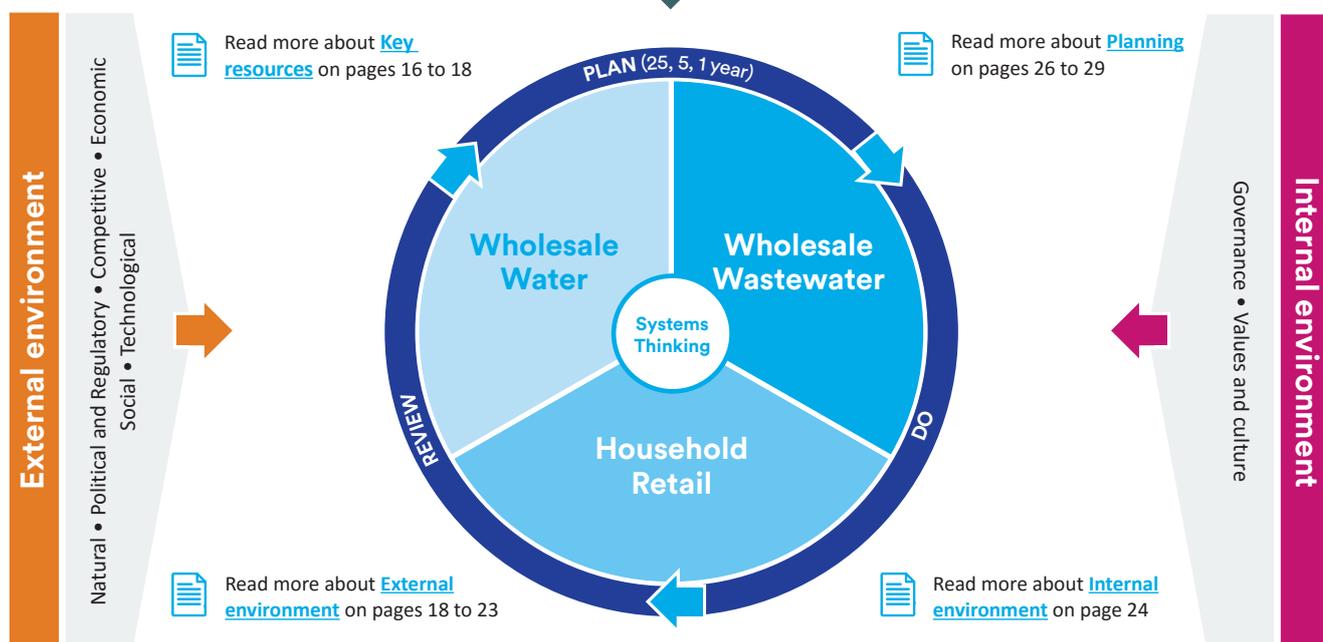
<h3>Systems Thinking approach to how we operate improves efficiency and resilience</h3> <p>We have adopted an innovative systems-based approach to our regional water system and wastewater drainage areas which we call Systems Thinking.</p> <p>By thinking of our entire network as a system, and using our integrated control centre, we are able to optimise cost and service performance, as well as encourage a proactive, rather than reactive, culture.</p> <p>This helps us to:</p> <ul style="list-style-type: none"> <li>improve the reliability of our assets to reduce unplanned service interruptions;</li> <li>improve our use of data, at local asset level and centrally, to optimise performance; and</li> <li>allocate resources to production teams with full accountability for asset and system performance.</li> </ul> <p>This approach was built into our business plan in order to help us deliver both operational improvements and cost savings across the regulatory period.</p> <p>As a result of this Systems Thinking approach, we are improving the resilience of our assets and network. This enables us to continue to provide a reliable service to our customers long into the future.</p>	<h3>Prudent financial risk management delivers long-term predictability</h3> <p>Our clearly articulated financial risk management policies, covering a variety of market risks, help us reduce our exposure to the economic and regulatory environment, therefore providing more predictable returns to investors.</p> <p>Our policy on inflation hedging is to match the debt portion of our RCV, offset by the effect of our pension scheme liabilities, with index-linked debt. This provides equity shareholders with a reliable one-to-one exposure to RPI movements, controlling the risks of unexpected movements in inflation.</p> <p>Interest rate exposure on our remaining nominal debt is managed by fixing the underlying interest cost out to 10 years, on a reducing balance basis, and is supplemented by substantively fixing interest rates for each forthcoming regulatory period at the time of the price control determination. This enables us to manage uncertainty in the approach to setting the cost of debt at each price review, and our approach to debt financing enables us to consistently lock in long-term debt at good relative value.</p> <p>We adopt an asset-liability matching policy for our defined benefit pension schemes by investing in assets such as fixed income swaps, corporate bonds and gilts which perform in line with the liabilities so as to hedge against changes in swap and gilt yields. This therefore reduces the volatility of the required funding level.</p> <p>The pension schemes also hedge inflation exposure, partly through RPI swaps and partly through an inflation funding mechanism, whereby company contributions are flexed for movements in RPI, providing a natural hedge against any inflationary uplift on the RCV.</p>
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 Read more about [Systems Thinking](#) on page 30

 Read more about our [Financial risk management](#) on pages 152 to 159

# Our business model

Key resources			
<b>Natural resources</b> <ul style="list-style-type: none"> <li>› Collect water for treatment</li> <li>› Maintain sustainable catchment land, protecting the natural environment</li> <li>› Process waste to generate renewable energy</li> </ul>	<b>People</b> <ul style="list-style-type: none"> <li>› Develop and motivate our diverse workforce</li> <li>› Management incentives based on performance</li> <li>› Working with suppliers who share our values</li> </ul>	<b>Assets</b> <ul style="list-style-type: none"> <li>› Significant capital investment programme</li> <li>› Efficient maintenance of long-term fixed assets</li> <li>› Innovative solutions and Systems Thinking approach</li> </ul>	<b>Financing</b> <ul style="list-style-type: none"> <li>› Robust capital structure</li> <li>› Long-term debt locked in at good relative value</li> <li>› Proactive engagement with equity and credit investors and access to range of markets</li> </ul>



**The best service to customers**

**Outcomes**

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

**At the lowest sustainable cost**

**Outcomes**

- › Value for money
- › Improved efficiency

**In a responsible manner**

**Outcomes**

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

## Provide an appropriate risk and return for investors

### How we measure our performance – operational KPIs

<ul style="list-style-type: none"> <li>› Wholesale ODI composite</li> <li>› SIM – qualitative</li> <li>› SIM – quantitative</li> </ul>	<ul style="list-style-type: none"> <li>› Totex outperformance</li> <li>› Financing outperformance</li> <li>› Household retail cost to serve</li> </ul>	<ul style="list-style-type: none"> <li>› Leakage</li> <li>› EA performance assessment</li> <li>› Dow Jones Sustainability Index</li> </ul>
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Read more about [Outcomes](#) on page 31

Read more about [Risk](#) on pages 46 to 49

Read more about [KPIs](#) on pages 31 to 33

## How we engage with our stakeholders

Delivering water and wastewater services to 7 million people in the North West brings us into contact with a wide variety of stakeholders. Ensuring we build strong, constructive relationships with them is vital for the success of our business.

We approach stakeholder engagement in an inclusive way, taking time to understand which stakeholders are interested in which topics, holding genuine, two-way conversations with them and, through continuous engagement, working hard to understand any concerns or issues from their perspective to ensure a suitable response from the company.

Interactions with our stakeholders take many forms, from formal meetings to day-to-day contacts, and focus on a range of topics from the future direction of the sector through to everyday operational matters.

**Customers** – through continuous focus on improving service, we can help to build their trust and confidence in our service delivery.

**Suppliers** – by maintaining a good relationship and working towards the same goals, we can deliver projects on time, to budget and to the required quality.

**Investors and analysts** – to help them understand our business in order to assist them in making the right investment decisions for themselves, their investors and clients.

**Regulators** – to help shape the policy and regulatory framework within which we operate.

**Third Sector and NGOs** – through engagement with groups representing economic, environmental, social and governance interests, we can better understand their issues and seek solutions to what are shared problems.

**Politicians** – by maintaining good lines of communications with North West MPs and their local offices, we can help resolve water-related constituency issues as well as discuss national policy topics.

**Devolved authorities** – by engaging with the emerging devolved arrangements, such as new metropolitan mayors, we can better understand the needs of the region we serve.

## Business insight

### Public consultation for the West Cumbria Pipeline

Ennerdale Water and the River Ehen, in West Cumbria, are habitats for protected species. To avoid the risk of long-term damage to the wildlife that relies on these water sources, we need to stop using Ennerdale as a source of water by 2022 when the Environment Agency withdraws its abstraction licence. To replace the loss of Ennerdale as a water source, we will be linking customers in parts of Cumbria to our regional water network by constructing a major new pipeline from Thirlmere to West Cumbria, a new water treatment works, pumping stations, and underground service reservoirs. By tapping into the spare capacity at Thirlmere reservoir, and with careful planning, we can ensure enough water for West Cumbria's households and businesses, whilst playing our part in giving nature a helping hand.

This project is as much about where we are working as it is about what we are building. It required planning permission from three local authorities – Copeland, Allerdale and Lake District National Park Authority. The scheme received approval in November 2016 and all three planning decisions were unanimous. This is no mean feat considering the largest section will require a 40-metre wide passage through a number of designated areas in the Lake District National Park.

This result is the culmination of several years of detailed planning and consultation with our customers. We've worked closely with local communities, businesses and stakeholders to develop the scheme, ensuring we minimise traffic inconvenience and safeguard the environment during construction.

Since 2013 we have carried out four phases of public consultation resulting in over 50 public exhibitions held in locations across Cumbria, over 150 local and parish council meetings, and many other stakeholder consultations. The standard and level of detail was commended by all three planning authorities and helped them reach their decisions.

It also means we have now achieved the first four ODIs, which are applicable to this scheme, and all ahead of time. It is worth noting that these first ODIs were critical in achieving the remaining milestones.

Work on the new pipeline has now begun, with the project due to be in service by March 2022.

Pictured: Our partnership with the West Cumbria Rivers Trust supports environmental engagement with the local community as well as a visitors drop-in centre in Keswick.



You can find out more about our consultation by watching a short video online at

[unitedutilities.annualreport2017.com/strategic-report/our-business-model/how-we-engage-with-our-stakeholders](https://unitedutilities.annualreport2017.com/strategic-report/our-business-model/how-we-engage-with-our-stakeholders)

# Our business model

## Key resources

### Natural resources ■

Our 'Instrument of Appointment' or Licence is essential for us to utilise the natural environment in the North West to create value for our business.

#### Raw water

Rainfall in the North West is greater than in other parts of the country, and therefore water supply is not as constrained. Nonetheless, it is in everyone's interest to make the most of this precious resource. We continuously encourage our customers to use water more efficiently and have increased the number of households fitted with meters. Our water-saving initiatives can save our customers money on their bills as well as preserving this vital resource. We have a regulatory annual leakage target, based on the sustainable economic level of leakage, and we have consistently met or outperformed this target.

#### Catchment land

We own over 56,000 hectares of land around our reservoirs. Our sustainable catchment management programme (SCAMP) has shown that we can effectively manage these catchments to protect and enhance water quality, and to provide other benefits such as an improved natural environment. Our Catchment Wise project is looking at working with others to improve the lakes, rivers and coastal waters where we return wastewater in the North West.

#### Bioresources

Another key resource is waste. Bioresources from wastewater can be processed to generate renewable energy, helping to save power costs and providing an ongoing opportunity to reduce carbon emissions. Our advanced digestion facility at Davyhulme is one of the largest works of its type and we now inject biogas from Davyhulme's wastewater treatment into the national gas network. We recycle waste by supplying treated bio solids to agriculture, which provides a valuable resource for farmers.



Pictured: Our advanced digestion facility in Davyhulme, Manchester.

### People ■■■

Our employees play a critical role in increasing long-term value generation. Fundamental to the decisions we take, and the operational performance we deliver, is a skilled, engaged and motivated team.

#### Wages and long-term incentives

Our employees are paid a competitive base salary along with a staff benefits offering and the opportunity to join both the employee healthcare scheme and our share incentive plan. Independent studies have shown that this enhances the quality of work, increases employee retention and reduces absenteeism, in addition to providing societal benefits. Management has a range of incentives which focus on performance over a number of years, rather than just the current year, to encourage the delivery of benefits over the longer term.

#### Human resources 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, and disabled colleagues have equipment and working practices modified for them, as far as possible, wherever it is safe and practical to do so. We have procedures and policies in place to ensure we act in accordance with the Universal Declaration of Human Rights.

#### Diverse workforce

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

### Gender diversity across our business



Male		No.	%
■	Group board	6	75%
■	Executive team*	4	57%
■	Senior managers	40	85%
■	Wider employees	3,404	63%
Female			
■	Group board	2	25%
■	Executive team*	3	43%
■	Senior managers	7	15%
■	Wider employees	1,973	37%

\* Figures exclude CEO and CFO, who are included in the group board figures

As at 31 March 2017, there were 15 male (88 per cent) and 2 female (12 per cent) employees who were appointed as statutory directors of subsidiary group companies but who do not fulfil the Companies Act 2006 definition of 'senior managers'.

#### Key:

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

## Health and safety

The health and safety of our employees is fundamental, both for their welfare and to the reputation and performance of our company. This continues to be a significant area of focus as we strive for continuous improvement. We have implemented a number of initiatives over recent years to improve health and safety conditions for our employees, and have been awarded the UK Workplace Wellbeing Charter.

## Supply chain relationships

Our suppliers and contractors provide us with essential services which we rely on to deliver our strategy, and we work with those whose business principles, conduct and standards align with our own. Our key suppliers have committed to our Sustainable Supply Chain Charter, further supporting the delivery of these benefits. Our suppliers are contributing significantly towards the c£9 billion forecast contribution we are making to the regional economy over the 2015-20 period.

## Employee training and development

We place a strong emphasis on providing comprehensive training and development opportunities for our employees, which helps to improve our internal skills-base as well as create a more engaged workforce.

We strive to enhance our understanding of best business practices in other companies and sectors around the world and, by bringing this learning back to our business, we have increased our organisational knowledge and capability. This has been integral to developing our Systems Thinking approach to operating our business.

Our award-winning apprentice scheme, coupled with our graduate recruitment programme, is helping to ensure we can continue to attract and train a high calibre of engineers, in a profession which has seen declining numbers in the UK in recent years.

## Business insight

### Developing our workforce for the future

We recognise that there is a wealth of unlocked potential within the diverse communities in which we operate. We invest and support these communities through a range of early careers activities and structured training programmes. These include our Apprentice, Degree apprentice and Graduate programmes, the Youth Employment Programme – NEET (not in employment education or training) and STEM (science, technology, engineering and mathematics) Careers Support.

We have found it increasingly difficult to find and attract experienced individuals with specific cyber capabilities. There is a relatively low availability of these skills in the North West, and in the UK as a whole, but an increase in demand for these capabilities.

Our cyber apprentice programme, begun in September 2014, has helped us with this challenge and we completed our first apprenticeship transition to a permanent role in September 2016. We are now almost half-way through our second cyber apprentice programme, with plans for a third to start in September 2018.

We will be exploring how we widen cyber training to include more industry and government collaboration and are liaising with Defra and the National Cyber Security Centre (NCSC) about such opportunities and to see how this training fits in with the wider government apprenticeship agenda.

The opportunity to have secondments outside of our business, and to offer secondments to the NCSC, will prove invaluable as we collectively face the cyber challenge across the water sector.

Our Operational Capability Review highlighted a potential business risk for telemetry/instrumentation control and

automation (ICA) roles. Historically, we have found these roles difficult to fill so we took the decision, based on success in other areas, to grow our own talent in this field.

We've worked nationally to develop a new apprentice standard for this role, and have expanded our own Technical Training Centre in Bolton to include a Telemetry/ICA section.

Funds have been invested in resourcing kit and the latest industry standards. A technical trainer has been recruited to deliver and develop a full, tailored curriculum to enable us to grow the best talent for the job.

Our first batch of eight telemetry/ICA apprentices began in September 2016. They are the first step in enabling us to meet our long-term business needs and grow the workforce of the future.

Pictured: Apprentices Alex Ward (left) and Kensy Hodgson.



# Our business model

## Assets

Our fixed assets (including all our reservoirs, treatment works and pipes) have a gross replacement cost of around £90 billion which is the estimated amount it would cost for another company to build similar assets and networks. However, it is not the replacement cost of our assets upon which we are allowed to earn a return through our revenues. We earn a return on our regulatory capital value (RCV), a regulatory measure of the value of our capital base, which is currently just over £10 billion, so it is this asset value which is more important economically.

### Long-term solutions

Many of our assets are long-term in nature, for example our impounding reservoirs have a useful economic life of around 200 years. By carefully reviewing our potential capital projects, and considering the most efficient long-term solutions, we can save future operating costs, help to reduce future customer bills, and work towards being able to operate in a more sustainable manner. It is important that we have the right systems and procedures in place in order to monitor and control the assets efficiently and effectively within our network. Embracing innovation in our asset configuration and work processes can help to make our future service better, faster and cheaper.

### Investing in the region

Since privatisation in 1989, total capital investment of over £15 billion has provided substantial benefits to our customers and our region's environment. It has also contributed to the North West's economy through job creation, both within our company and also in our supply chain. Disciplined investment, along with RPI inflation, also grows our RCV, increasing future revenues.

## 2015-20 investment programme

We expect to invest around £3.6 billion across 2015-20 and to continue with a substantial investment programme, for the foreseeable future, in order to meet more stringent environmental standards and to maintain and improve the current standards of our assets and services. When deciding on our investment strategy we have to be mindful of the impact on our customers' bills and this is why, for example, we are spreading some of the environmental spend, required by European legislation, over the next 15 years.

## Financing

### Capital structure

We aim to maintain a robust and responsible capital structure, balancing both equity and debt, to achieve a strong investment grade credit rating. Our proactive equity and credit investor programmes allow us to engage effectively with investors. Issuing new debt is particularly important as our capital investment is largely financed through a mix of debt and cash generated from our operations. We maintain access to a broad range of sources of finance, in a number of markets, across which we seek best relative value when issuing new debt.

### Controlling our finance costs

Locking in long-term debt at good relative value can help keep our finance costs low and give us the potential to outperform the industry-allowed cost of debt. Sustained low-cost finance across the industry benefits customer bills. The average life of our term debt is around 20 years. Our prudent financial risk management policies, covering credit, liquidity, interest rate, inflation and currency risk, help reduce the group's exposure to changes in the economic and regulatory environment.

## External environment

### Natural environment

Whether it is treating and delivering drinking water for our customers, or returning treated wastewater to rivers and the sea, the natural environment is fundamental to our business. We continue to invest in the protection and, where appropriate, enhancement of the natural environment of the North West. This in turn brings economic benefits such as underpinning the region's tourist industry.

### Preparing for climate change

We plan far into the future to ensure we are prepared for the changing natural environment, most notably the risks and opportunities presented by climate change. With severe dry periods becoming increasingly common, we must ensure we continue to have resilient water resources and an infrastructure capable of moving water efficiently around the region. At other times, we must tackle flooding incidents caused by the intensive bursts of rainfall which are becoming more frequent due to changing weather patterns. The potential effect of climate change on our future water resources is included in our 25-year Water Resource Management Plan.

### Preparing for a changing population

Additionally, we must ensure we are able to meet increased demand on our sewerage network as the regional population is expected to increase. A phased, long-term approach ensures that the necessary work can be delivered without placing too much pressure on customer bills.

### Returning water safely to nature

We have a responsibility to return water to the environment safely. Spills from our network can lead to pollution which, depending on their severity, can damage the natural environment and potentially lead to loss of reputation and financial penalties. We have had one of our best years in relation to serious pollution incidents, and it remains an important area of focus. The Environment Agency assesses water companies' performance across a basket of measures, including pollution, and its overall assessment is included as one of our KPIs (see page 32). All of the pollution sub-measures are reported within our Corporate Responsibility pages on our website at:

[corporate.unitedutilities.com/cr-environment](http://corporate.unitedutilities.com/cr-environment)

### Reducing our environmental impact

We can make an important contribution to protecting and enhancing the natural environment by using fewer natural resources. We have been driving down our carbon footprint over the last decade (22 per cent fall in CO<sub>2</sub> emissions since 2005/06) and have plans to reduce it further. Less than 6 per cent of our waste goes to landfill and our use of recycled products is increasing. We plan to substantially increase our renewable energy production from 2015 to 2020 with the main contributor being solar opportunities. This will provide environmental benefits and add value to shareholders through energy cost savings.

## Business insight

### Our road to resilience

We face resilience challenges across our business in systems, finance and skills, as well as in customer and stakeholder expectations for a reliable, wholesome water supply and good environmental management. Resilience is not a new issue for us. However, delivering the level of resilience now expected by customers, in light of pressures from a changing climate, growing population, ageing infrastructure and market competition, may lead to some significant redirection of investment, particularly in ensuring the ongoing resilience of key population centres like Manchester and Liverpool.

We have been at the forefront of managing record-breaking extremes of weather over the last few years. This has actively tested our resilience and our response and recovery capabilities. Given the scale of the flood events in December 2015, the fact that relatively few customers suffered interruptions to their water supply highlights an underlying level of resilience. But there is still room for improvement. The Lancashire water quality incident we experienced during 2015 tested our ability to respond to such a large scale event, and regrettably, it had a significant impact on a large number of customers over a prolonged period.

We learnt a great deal from our experiences and have already made significant progress in enhancing our resilience. We are following a risk-based approach to better understand our overall risk and prioritise actions to reduce it further. Our methodology is aligned with both the UK Water Industry Research Ltd (UKWIR) document 'Resilience Planning: Good Practice Guide' and the Cabinet Office guidance 'Keeping the Country Running: Natural Hazards and Infrastructure' which advocates consideration of the 4Rs to address system resilience risks:

- › redundancy – backup installation or spare capacity to allow continuity of service;
- › resistance – providing strength or protection to resist a hazard impacting;
- › reliability – design systems to continue operating under a broad range of conditions; and
- › response and recovery – plan to ensure a fast, effective response to disruptive events.

Redundancy and resistance are generally seen as being the most effective at removing risk but tend to be at the highest cost. A risk-based approach allows all mitigating actions to be assessed on a like-for-like basis. Every intervention cost can be compared to the risk benefit ensuring that interventions can be prioritised and tested for value for money. Other activities underway include:

- › understanding our customers' needs and providing them with a better service during events;
- › investing in our assets to reduce the likelihood of a large scale disruption to service;

- › training our people and reinforcing the importance of delivering a resilient service; and
- › testing and enhancing our contingency planning capability.

Through the rest of this 2015-20 regulatory period, and into the next, we will continue to develop our understanding of the risks and take further action to control them where appropriate, including:

- › as part of our responsible approach to resilience, and based on outperformance we have earned to date, we aim to make around £100 million available for additional investment across this regulatory period to deliver significant resilience benefits;
- › gaining insight from our inspection of the Haweswater Aqueduct about the resilience of supplies, to a growing population in Manchester, and determining what needs to be done to ensure the supply is secure now and remains so in the future;
- › developing a resilience measure that will help customers understand the level they currently experience so that we can have a more informed conversation about how much they value resilience of service compared to other risks; and
- › enhancing our response and recovery plans, for the most significant risks, to ensure that, should the worst happen, we can recover service as quickly as possible.

Our experience in this regulatory period will deliver a more secure and reliable service to customers in the future. There are other trends that we need to manage to deliver long-term resilience:

- › population growth – the number of households we supply is expected to grow from 3 million now to 3.6 million by 2040;
- › ageing demographic – as people live longer, there will be a higher proportion of older customers. These changing demographics will affect our services – from our core water and wastewater services to support services such as customer liaison;
- › evolving technology – there will be technological advances and changes in the way in which we communicate with one another. We will adapt our customer services to meet the demands and expectations of our customers; and
- › climate change – as the UK climate continues to change, with severe dry periods becoming increasingly common, we must ensure we continue to have resilient water resources and an infrastructure capable of moving water efficiently around the region. We must seek to tackle flooding incidents caused by the intensive bursts of rainfall, which are becoming more frequent due to changing weather patterns.

In order to maintain a reliable, high quality water and wastewater service for our customers in the future, we have to anticipate those changes and core issues that are likely to impact on our activities and balance them against our customers' priorities.

# Our business model

## Political and regulatory environment

Over a long time frame the political and regulatory environment can change significantly. In the 28 years since the UK water industry was privatised, we have seen substantial tightening of laws and regulations. While to some extent changes to the regulatory environment are outside of our direct control, maintaining good relationships is important to enable positive participation in regulatory discussions. By positively engaging, and using our industry knowledge, we can help influence future policy with the aim of achieving the best outcome for our customers, shareholders and other stakeholders.

## Economic regulation

The water industry currently operates within five-year planning cycles known as Asset Management Plan (AMP) periods. Prior to the start of each five-year period, companies submit their business plans which include their projected expenditure to enhance and maintain their assets. Following review of these plans, Ofwat sets the prices each company can charge their customers across the period. This report covers the second year of the 2015-20 (AMP6) period.

Ofwat introduced a number of important changes for the 2015-20 period, with the aim of evolving the sector in order to meet future challenges and placing greater focus on customers' needs.

Moving away from one single price control, there are now four separate price controls:

- › wholesale water – covering the physical supply of water;
- › wholesale wastewater – covering the removal and treatment of wastewater;
- › domestic retail – covering customer-facing activities (principally customer contact, billing, meter reading and cash collection) for household customers; and
- › non-household retail – covering customer-facing activities for business customers.

Separate retail price controls should provide retail businesses with greater incentives and focus on delivering a more efficient service to non-household customers, as competition expands, and to household customers under an industry average cost to serve approach.

The way companies' operating and capital costs are assessed has been modified to encourage them to utilise the most efficient, sustainable solutions under a totex model that looks at capex and opex together and treats them equivalently. Where companies out/underperform their totex allowance, this gain/pain is shared between investors and customers, ensuring both receive the impact.

In a move to a more outcomes-based approach, there was greater emphasis placed on customer engagement to set the outcomes. Companies' performance is now measured through a range of outcome delivery incentives (ODIs) covering a wide range of measures assessing operational and environmental performance, with associated rewards or penalties.

Ofwat (the Water Services Regulation Authority) is the economic regulator of the water and sewerage sectors in England and Wales, responsible for ensuring the companies provide customers with good-quality, efficient service at a fair price.



Read more online at:  
[ofwat.gov.uk](http://ofwat.gov.uk)

Ofwat's service incentive mechanism (SIM) assessment is continuing to be used as a measure of customer satisfaction. This will reward companies who perform well on customer service, or penalise companies who perform badly, relative to other water companies.

Each year all water companies are required to publish an annual performance report, the first of which was published in July 2016 and can be found on our website, where our report for this financial year will also be made available:

[corporate.unitedutilities.com/annualperformancereport](http://corporate.unitedutilities.com/annualperformancereport)

## Market reform

From 1 April 2017, the 2014 Water Act opened retail competition to all non-household customers, including sewerage as well as water services. We are well positioned following our experiences in the competitive Scottish market and our JV with Severn Trent, combining our respective non-household retail businesses under Water Plus.

Following a request from Government, Ofwat assessed the potential costs and benefits of extending retail competition to household customers, and recently reported back to Government.

The Water Act paves the way for the future introduction of competition for certain parts of the wholesale, or upstream, business. Ofwat proposed, in its Water 2020 consultation document in 2015, to open up competition in the areas of water resources and sludge treatment from 2020.

We are fully engaged with regards to market reform, being always mindful of the potential impact on our customers and the value implications for our shareholders.

## Environmental and quality regulation

The water and wastewater industry in the UK is subject to substantial domestic and European Union regulation, placing significant statutory obligations on water and wastewater companies with regards to, among other factors, the quality of drinking water supplied, wastewater treatment and the effects of their activities on the natural environment.



**Defra** is the UK Government department responsible for water policy and regulations in England and Wales; it sets drinking water quality and environmental standards (many based on European law) which water companies must meet.

Read more at: [gov.uk/defra](http://gov.uk/defra)



**The Environment Agency** controls how much water can be drawn from the environment and the quality of water returned to rivers and the sea. The EA produces an assessment of water and wastewater companies' annual performance, and we include this as one of our KPIs, see page 32. Read more at: [gov.uk/government/organisations/environment-agency](http://gov.uk/government/organisations/environment-agency)



**The Drinking Water Inspectorate** is responsible for ensuring compliance with the drinking water quality regulations. Read more at: [dwi.gov.uk](http://dwi.gov.uk)



**Natural England** is responsible for the protection of designated sites for nature conservation, for example Sites of Special Scientific Interest. Companies are required to manage these sites and to protect and enhance biodiversity. Read more at: [naturalengland.org.uk](http://naturalengland.org.uk)



**The Consumer Council for Water (CCW)** represents customers' interests relating to price, service and value for money. It investigates customer complaints. Customers who remain dissatisfied can refer their complaint to be adjudicated by an independent service, WATRS (see below). Read more at: [ccwater.org.uk](http://ccwater.org.uk)



**WATRS** is an independent service designed to adjudicate disputes that have not been resolved through the water company's customer service teams or by referring the matter to the Consumer Council for Water. Read more at: [watrs.org](http://watrs.org)

## Competitive environment

The other water companies in England and Wales are naturally our main competitors and we benchmark our performance on a comparative basis. Away from the water sector, in line with our vision to be the best UK water and wastewater company, we benchmark our customer service performance against other leading service providers in our region. In addition, as a publicly listed FTSE 100 company, the other UK and worldwide listed utilities are competitors from an investment perspective.

### Value creation

We create value for our stakeholders principally by agreeing and then delivering, or outperforming, our regulatory contract. The way we use our key resources, manage our internal environment and interact with our ever-evolving external environment, influenced by our long-term strategic approach, helps to achieve value creation. This facilitates the delivery of outcomes for our customers, employees, the environment and communities, alongside ensuring investors receive an appropriate return. This is represented in the diagram on page 14, with the subsequent pages of this report mapping to its colour-coded sections.

 Read more about our [Our competitive advantage](#) on page 13

### Performance measurement

Our key performance indicators for 2015-20 measure our progress against some of the most important value drivers for the business, feeding through from our strategic themes to deliver **the best service to customers, at the lowest sustainable cost, in a responsible manner.**

 Read more about our [KPIs](#) on pages 31 to 33

### Decision-making

Systems Thinking lies at the heart of our day-to-day decision-making, from approving our capital expenditure programmes to agreeing our supply-chain partners. Whilst the financial impact is a key driver in decision-making, this is always set in the context of the impact on customers, shareholders, the environment, employees, communities and other stakeholders. For many years, we have included corporate responsibility factors as strategic considerations, supported by our corporate responsibility committee which is chaired by one of our non-executive directors.

 Read more about our [Governance](#) on pages 52 to 117

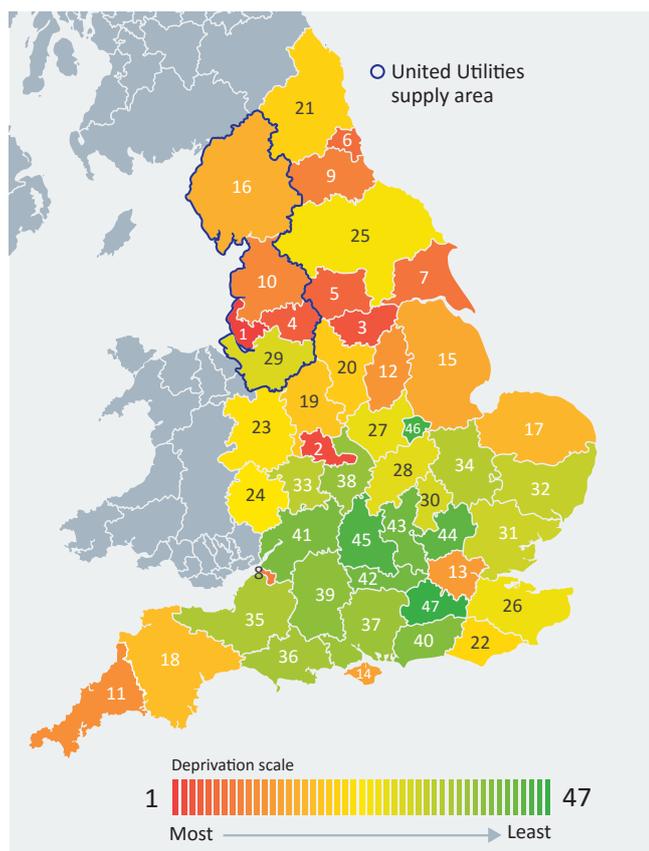
# Our business model

## Economic environment

Changes in the economy, such as inflation, interest rates or unemployment levels, can influence our ability to create value. While they are outside of our direct control, we can mitigate some of the potential adverse impacts associated with market movements, such as on inflation and interest rates, through our hedging strategies.

## Regional deprivation

In recent years, unemployment in the North West has generally been higher than the national average. However, over the last year this unemployment rate has improved faster than, and is now broadly in line with, the national average. A report from the Department for Communities and Local Government, published during 2015/16, reaffirmed that the North West has the most deprived regions in England, with three of the top five local authority districts with the highest proportion of 'highly deprived' neighbourhoods (categorised as the most deprived 10 per cent). Even as the North West's economy recovers, it is unlikely to have a significant impact on deprivation, which is the principal driver of our higher than average costs to serve for our household customers. This is currently recognised by Ofwat through a special allowance for deprivation of £20 million per annum over the 2015-20 period.



**Pictured:** Map of English counties ranked by multiple deprivation index score. For more details visit [gov.uk/government/collections/english-indices-of-deprivation](http://gov.uk/government/collections/english-indices-of-deprivation)

Bad debt remains a risk to which we are exposed, particularly with the continuing tightening of real disposable incomes and the impact of recent welfare reforms likely to intensify. Whilst our debt management processes have been externally benchmarked as efficient and effective, we continue to refine and enhance them

whilst also helping customers back into making regular payments through the use of manageable payment plans.

## Market rate movements

Interest rates have remained below the long-term trend and we have benefited from this as we drew down, or raised, over £600 million of new debt in 2016/17. Comparatively low interest rates have also been beneficial to our future cost of debt as we continue with our interest rate hedging strategy.

RPI inflation has risen since the UK voted to leave the European Union, increasing to 3.1 per cent at March 2017, following on from lower inflation over the last couple of years. However, RPI inflation remains on the low side versus levels seen in the last 10 years. The prices we charge our customers (and therefore revenues), as well as our asset base, are linked to RPI inflation, so lower RPI has meant slightly lower growth on these measures.

However, we have a large quantity of index-linked debt which means our finance costs decrease as inflation falls, providing a partial economic offset to revenue (although this is not a perfect hedge as changes to revenue and index-linked finance costs are based on differing lagged measures of inflation). Our pension liabilities are linked to inflation, which provides an additional economic offset against our asset base. Overall, we are currently more inflation-hedged than the other listed water and wastewater companies so we are better protected in a low inflation environment.

## Economic contribution

United Utilities' total forecast contribution to the regional economy, over 2015-20, is estimated at £9 billion. Direct economic contributions from our activities include the purchase of goods and services and providing extensive employment. There is also an indirect economic contribution, for example, when our suppliers make purchases from their suppliers and when people, whose jobs are supported by United Utilities, spend their personal incomes.

## Social environment

We see some significant societal trends that we plan to address in our long-term strategy.

## Population changes

We anticipate an increase in the North West's population of around 600,000 by 2040 (more than the population of a large city such as Liverpool). We are planning to ensure our services, and supporting infrastructure, meet the needs of this growing population, which will include a higher proportion of older people. The North West remains the most socially and economically deprived region in England and so we can anticipate continued hardship for a number of communities and difficulties for some customers in paying their bills. We will remain committed to supporting these customers through a suite of payment assistance schemes and by looking at new ways to help, like the introduction of our social tariff in 2015, supporting older customers. We are also adapting to the increasing use of social media and digital technology by our stakeholders.

## Investing in local communities

The communities in which we operate are of great importance to our business – they are 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 on the community and invest in programmes that support affected areas or help tackle current social issues.

## Technological environment

Advances in technology can be used to help deliver improvements in the quality or cost of our service. Embracing innovation, using modern technology or techniques, is at the heart of how we do business. Our Systems Thinking approach across the wholesale business is a key example of this.

### Energy generation

We have been utilising technology within our energy self-generation. For example, our Davyhulme sludge recycling centre employs a ground-breaking configuration of thermal hydrolysis to maximise energy generation from sludge and won an Annual Institute of Chemical Engineers award for innovation in 2013/14. Then in 2015/16 we built Europe's largest floating solar array system on our reservoir in Godley, Greater Manchester.

### Technological risks

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

### Changing customer behaviours

We must be mindful of our customers' ever increasing use of technology. We have recognised the increasing power of social media as communication channels for customers, and we recently invested in a new digital external communications capability and a number of website improvements.



**Pictured:** Our new mobile app allows customers to pay their bill and give a meter reading via their smartphone.

## Business insight

### Delivering our digital strategy

Four years ago we began a journey to improve our core IT provision and develop the deep foundations necessary for a relevant and efficient digital water and wastewater business.

During 2016/17, non-household competition provided an opportunity to demonstrate and leverage our investment in digital foundations and our capability with data. We delivered a business-to-business digital integration platform which connects United Utilities wholesale systems to the market operator of England's non-household water market (MOSL) and market participants. Our data analytics investments delivered high data completeness scores for market entry and continue to support our market activities. This enabled United Utilities to enter 'Shadow Operations' with live transactions in October 2016 and successfully complete full market opening in April 2017.

In addition, we are driving forward a digital strategy which has seen us deliver new handheld smartphone devices and applications to employees across job functions to provide data at the point of need and to establish the foundation for future rapid delivery of digital apps. This improvement is already changing the way we think about data and processes and enabling new innovation and improvements which were previously too complex or costly to implement.

As part of our market readiness systems, we use simple robotic process automation (RPA) techniques to improve the efficiency of case creation by automating high frequency tasks triggered by market transactions. This early use of RPA has taught us some useful lessons and helped inform our next steps in the practical use of software robotics and automation. We will use this learning to drive greater efficiency, quality and optimisation of our back office process.

To continue the improvement of our customer experience, we are investing in digital channels for our household retail customers including a new internet site, automated speech recognition and a customer mobile app.

We continuously track developments in technology, which could help our digital journey, and are investing in innovation to make sure we develop and exploit new technologies to maximum benefit. Specifically, we are investing in concept work around the use of Internet of Things (IoT) sensors and data analytics to enhance situational awareness and available data more dynamically with increased cost efficiency. We believe the use of this technology will unlock new automated and predictive ways of working and allow us to deliver better outcomes for all of our stakeholders.

# Our business model

## Internal environment

### Governance

Good governance lies at the heart of all successful organisations and leads to better management decisions as well as helping to avoid exposure to potential risks.

We strive to operate in a manner that reflects the highest standards of corporate governance. Our company structure and governance standards are designed to ensure that our board continues to observe sound and prudent governance in compliance with the principles of the UK Corporate Governance Code.

### Prudent risk management

As would be expected of the provider of an essential service, we adopt a prudent approach to managing risks to our business. That being said, accepting some level of risk is a normal consequence for a commercial organisation.

Given the complex legal and regulatory environment within which we operate, we are exposed to a range of risks. Risks can be in the form of possible non-compliance with existing laws or regulations, or failure to meet the terms of our current 2015-20 regulatory contract, and we face risks in relation to potential future changes in legislation or regulation, as well as from environmental impacts such as climate change.

An important risk to our business is ensuring that we get the constituent elements of our five-yearly business plans correct to ensure our financeability, and that they are agreed by Ofwat as we are bound by these plans for the following five-year period with limited opportunity to change them.

See pages 46 to 49 for more details on what we consider to be our principal risks and uncertainties.

Identifying and then being able to act upon potential opportunities can be a key determinant for adding value. Every quarter, senior management across each main area of the group routinely undertakes business reviews, including the identification and evaluation of potential opportunities.

We are committed to delivering our services in a responsible way and our approach to responsible business practice is outlined in our Business Principles document available on our website at: [corporate.unitedutilities.com/united-utilities-business-principles](https://corporate.unitedutilities.com/united-utilities-business-principles)



Read more about our [Governance](#) on pages 52 to 110

### Values and culture

Our culture is embodied in our three core values of customer focus, integrity and innovation, and we operate under these three core values at all levels of our business.

These core values are interrelated, as innovating to improve our services and acting with integrity in the way we carry out our activities all help us to continue to improve customer service.

### Customer focus

Everything we do will be about our customers, not us.

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

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

### Integrity

We will make promises knowingly and keep them.

Acting with integrity, both at board level and as a company, underpins our approach to responsible business and building trust. We actively encourage our employees to express their opinions and ideas through various engagement and social channels, such as our annual 'Your Opinion Survey', through news articles on our intranet, and on our social media collaboration tool Yammer.

### Innovation

We will innovate to make our services better, safer, faster and cheaper for our customers.

Innovation is a critical enabler in creating value, helping us to be ahead of our competitors, and we welcome ideas on how we can innovate across all levels of our business.

Our employees are given the opportunity to develop and present their ideas to senior management, facilitating and encouraging an innovative environment.

Utilising innovation from our suppliers is part of our supply chain approach, which provides another avenue to benefit from new ideas and technologies.



Read more about our [Values and culture](#) on page 65

## Business insight

### Challenging our graduates to innovate

The annual CEO Challenge, open to first and second year graduates, aims to find practical, innovative solutions to real business problems.

Our graduates are our thought leaders of the future and it is this population that participates in the challenge. The programme provides graduates with a unique, exciting experience and the opportunity to manage and implement their own live projects. They have to secure financial backing, work with internal and external stakeholders, control budgets, manage a project and get to grips with the technical details, in a short period of time.

The programme provides a safe learning environment for graduates in which they can thrive and deliver great solutions for the company. Graduates get exposure to senior leaders and to parts of the company they would not normally encounter. Past participants agree that the CEO Challenge is excellent for their personal development.

Our innovation team is on hand to offer guidance and support throughout the activity to ensure projects align to our business strategy and that the solutions provide a viable benefit to the business and to our customers.

The teams present their findings to a judging panel including the CEO and the Head of Innovation. A winning team is selected

and there are also individual awards and incentives to recognise high performance. For example, one 'rising star' award-winning graduate, from last year's CEO Challenge, is now working directly for our CEO.

Any team that develops a successful project has the opportunity to implement this into the business. There have been a number of projects that have delivered proven business benefits and are now rolled out across the organisation. Some examples are:

**TechTool** – used to determine appropriate options for performing rising main condition assessment and likelihood of failure. This has enabled the business to better inform maintenance investments and interventions regarding rising mains. It is now being utilised on an ongoing basis by the business.

**Odowatch (the electronic nose)** – a tool used to help us detect potential for odour problems early on, allowing us to act before our customers are affected.

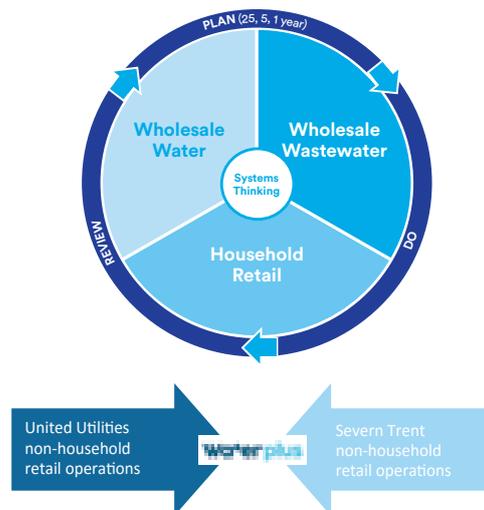
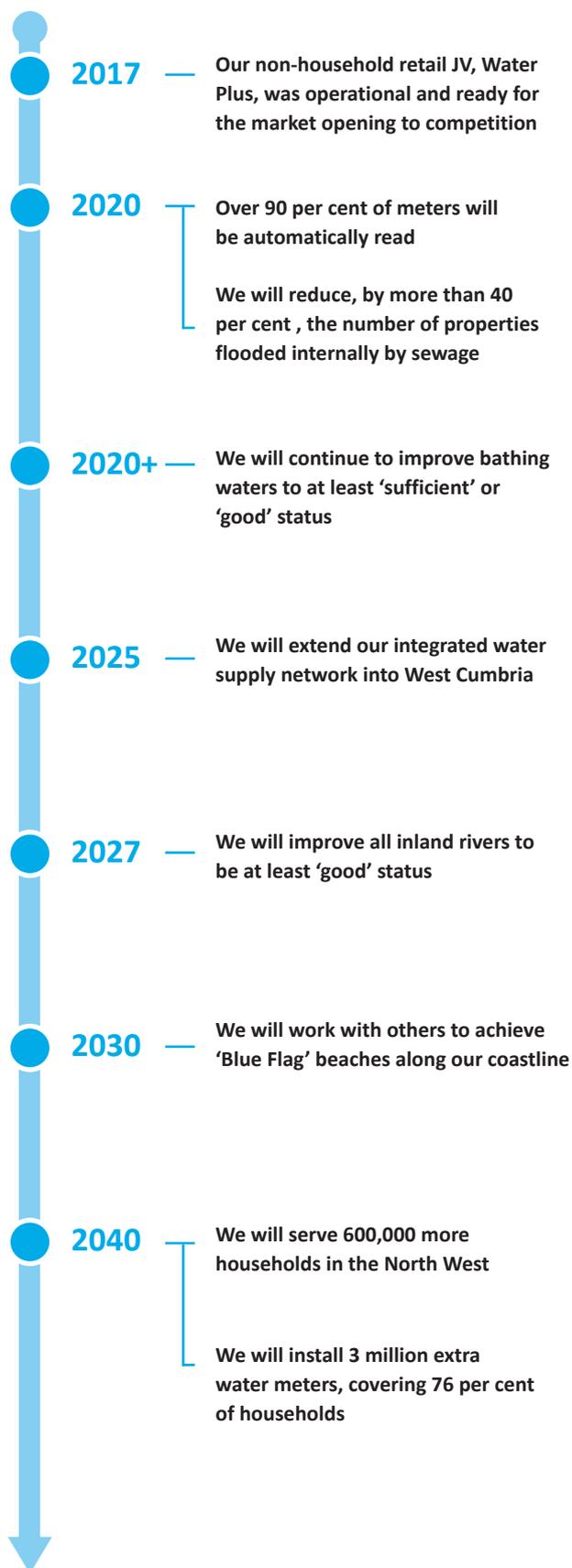
**Domestic Fats, Oils and Greases (FOG) campaign** – with the help of FOG funnels distributed to employees and, in collaboration with Sainsbury's, to our customers we were able to collect around 3,000 litres of FOG.

Pictured: Steve Mogford (centre) presents the CEO Challenge Award to this year's winning team of graduates.



# Our business model

## Planning – key milestones



## Planning cycles

We have structured our business in line with Ofwat's four distinct price control areas:

- › Wholesale water;
- › Wholesale wastewater;
- › Household retail; and
- › Non-household retail.

The non-household retail area is now subsumed within our joint venture with Severn Trent, Water Plus. While we can influence it, we cannot control it. It is not part of our consolidated group, therefore it does not form part of our group's business model.

The three business areas within our business model (wholesale water, wholesale wastewater, and household retail) undertake both long-term and shorter term planning to identify how they can best deliver their outcomes. We adopt an integrated approach, which considers a whole range of stakeholders including customers, investors, the environment, our employees and local communities. These plans take into account the internal and external factors described on pages 18 to 24. Underpinning our approach to planning, we undertake a cycle of continuous assessment using KPIs, and other performance measures, which helps us formulate our future improvement plans for our various stakeholders.

### Wholesale business areas

All of the group's RCV, of just over £10 billion, sits within the wholesale water and wholesale wastewater business areas, and we are allowed to earn an annual return on this asset base on the basis of an industry-allowed cost of debt and equity set by Ofwat. Allowed costs for both of these wholesale price controls are determined by Ofwat using its totex cost assessment models. Our cost performance against our allowed cost of debt and totex will determine how much outperformance or underperformance we generate.

### Retail business areas

Allowed costs within the household retail price control are determined using a water industry average cost to serve approach, rewarding companies who are able to achieve costs below the industry average. The opening of full competition in the non-household retail price control from 1 April 2017 provides a strong incentive for water companies to deliver efficiencies and service improvements in that area.

## Planning 25 years+

We provide an essential service and in order to maintain a reliable, high quality water service for our customers, we have to look a long way ahead, to anticipate and plan for the changes and core issues that are likely to impact on our activities. Our long-term strategy then helps us to define what we need to deliver over the shorter term, which in turn helps to create value.

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

- › climate change and its implications for water resources and flooding;
- › the emergence of a more open, competitive UK water market;
- › more rigorous environmental regulations;
- › population growth;
- › the implications of the UK's exit from the European Union; and
- › combining affordable bills with a modern, responsive service.

By anticipating and planning ahead, we can ensure that we continue to deliver what customers want at a fair price and in a responsible way, in line with our three strategic themes.

Our Strategic Direction Statement, 'Playing our part to support the North West', sets out our long-term strategy for the next 25 years, examining the challenges ahead and how we will focus our resources and talents in order to meet them.

We consulted with thousands of customers and other stakeholders to ensure their expectations are reflected in our plans.

Our 25-year Water Resource Management Plan sets out the investment needed to ensure we have sufficient water to continue supplying our customers, taking into account the potential impact of climate change.

Some of the key ways we create value over the long-term are by:

- › investing in our people to ensure a committed, capable and motivated workforce delivering high performance;
- › close collaboration with suppliers and disciplined investment, based on a sustainable whole-life cost modelling;
- › efficiently implementing a robust and appropriate mix of debt and equity financing;
- › embracing innovation to make our future services better, faster or cheaper;
- › long-term planning and management of water resources – 25-year Water Resource Management Plan;
- › responding to climate change; and
- › sustainable catchment management.



Read more online at [corporate.unitedutilities.com/future](https://corporate.unitedutilities.com/future)

## Business insight

### Supporting Defra's approach to the natural environment

Defra has established 'Pioneer' projects to explore, test and trial aspects of its approach to making the country the healthiest and most beautiful place to live, work and bring up a family, not just for today but for generations to come. The aim is that we will be the first generation to leave the natural environment of England in a better state than we found it. The Pioneer projects will:

- › test new tools and methods that apply a natural capital approach in practice;
- › demonstrate a joined-up integrated approach to delivery;
- › pioneer and 'scale-up' the use of new funding opportunities; and
- › grow our understanding of 'what works', sharing lessons and best practice.

These four 'asks' form the basis of the Pioneers and each will seek to apply them within their respective environments (urban, catchment, marine and landscape). It is a principle of the Pioneers that they will need to be flexible and adaptable, trying new and innovative thinking and approaches and share the learning widely with others as they progress.

It is also a principle that the ways of working developed as part of the Pioneers utilise existing resources or secure new funding

sources to deliver environmental outcomes. The aim is that others can then replicate what is achieved.

We are actively supporting the two Pioneers that are just starting out in the North West. The urban Pioneer is set in the Greater Manchester City Region and the catchment Pioneer is being piloted in Cumbria. We will be contributing resources to both groups, as water is a key element of the natural environment, and the intent of the Pioneers supports our customer promise of protecting and enhancing the environment.

The purpose of the Cumbria Pioneer is to build on the work that has already been completed in the county, working together with partners and communities to share knowledge, learn lessons and encourage innovative ways of improving and investing in the environment.

The purpose of the Urban Pioneer is to make a clear and evident contribution to Greater Manchester's natural environment, engaging and connecting people with nature in their city, maximising their health and economic benefits through investment in the environment, creating sustainable growth and a good quality of life. It will support communities and decision-makers across Greater Manchester as they work to improve the environment, focusing on the local challenges and situations.

# Our business model

## Planning 5 years

Each five-year regulatory period is designed to help us achieve our long-term vision.

By submitting a robust, balanced plan to Ofwat, prior to the start of each five-year regulatory period, we can help ensure we receive a regulatory contract that allows for the best overall outcomes for our customers, shareholders and the environment.

Once each five-year regulatory contract is set, we create value principally by delivering, or outperforming, that contract by providing **the best service to customers, at the lowest sustainable cost, in a responsible manner.**

Our five-year plan for 2010-15 focused on improving customer satisfaction, meeting our statutory obligations and delivering shareholder value. We delivered on each of these, providing us with a strong platform to deliver further in 2015-20.

For the current 2015-20 regulatory period, some of the key ways in which we are aiming to create value are:

**Improve customer service** – improving efficiency and reducing costs, as well as improving our SIM performance to increase rewards / reduce penalties from Ofwat.

**Enhance our debt collection activities** – reducing retail costs, whilst providing the best support for customers struggling to pay.

**Minimise total costs on a sustainable basis** – for example, power, materials and property rates, which will help us to meet or outperform our allowed totex costs.

**Raise low-cost finance** – helping us to outperform our allowed finance costs, which is our main area of outperformance potential in this period.

**Deliver our operational and regulatory commitments** – helping to ensure we achieve high levels of customer service and meet environmental standards as well as improving our ODI performance to increase rewards / reduce penalties from Ofwat, in areas such as reliably delivered high-quality water, and reducing pollution and sewer flooding incidents.

**Implement our hedging strategies** – fixing medium-term interest rates and power costs helps us to meet our allowance by reducing the volatility of these costs.

**Increase our production of renewable energy from waste** – protecting us from rising energy costs and reducing our carbon footprint.

**Maintain a robust supply/demand balance** – providing water resource and customer supply benefits, as well as avoiding any penalties or unfunded expenditure requirements from our regulators.

**Supporting this value generation, each of our business areas has plans over 2015-20 to deliver as follows:**

### Wholesale water

Maintain existing high levels of reliability in the delivery of day-to-day water services, making better use of technology to monitor remotely and control more of our source-to-tap assets.

Maintain existing high levels of water quality as measured at customers' taps and our water treatment works.

Reduce the number of contacts from customers regarding water quality.

Maintain leakage at or below the sustainable economic level.

Limit the impact on customers of increases in operating costs, such as chemicals and rates, by making cost savings elsewhere through continuous improvement in the efficiency of our operations.

Commence work to link 150,000 customers in West Cumbria to Thirlmere reservoir to ensure a long-term, reliable supply of drinking water and to support the sensitive ecology in that area.

### Wholesale wastewater

Build on the customer satisfaction improvements we have already delivered. Continue to improve the way we operate, making better use of technology, automation and control to drive better customer service at reduced cost.

Reduce the number of our customers' properties exposed to sewer flooding by over 40 per cent, seeking opportunities to work in partnership with others to deliver schemes cost-effectively and promote the use of more sustainable drainage systems.

Improve the region's bathing waters to meet tougher regulatory standards, and work with other organisations to support them in delivering improvements to our region's beaches.

Improve water quality in the North West's rivers and lakes through investment in our treatment works and at overflows, reducing pollution. We are engaging with stakeholders to explore innovative catchment management techniques to control diffuse pollution in our catchments.

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

Constrain costs associated with taking responsibility for all private sewers and private pumping stations across the region, through improvements to our operating model and efficient delivery of our programme.

## Household retail

Continue to improve the customer experience by being more proactive with customers, anticipating problems before they materialise and improving our communication channels so that we are easier to do business with.

Reduce further the number of customer complaints and resolve them whenever we can, avoiding the need for complaints to be referred to the Consumer Council for Water.

Reduce the debt burden on the company and its customers by engaging with those who are struggling to pay, helping them return to sustained payment behaviour. We are extending our options for assistance to hard-pressed customers, including the social tariff, and we remain committed to contributing to the United Utilities Trust Fund, which has proven effective in helping customers in difficulty return to regular payment.

Reduce the cost to serve our customers through systems and process improvements. This is particularly important under the new price control methodology which uses an industry average retail cost to serve to determine part of customer bills.

## Planning 1 year

Each financial year, we develop a business plan which is approved by the board. This sets our annual targets which are designed to help deliver further improvements and move us towards achievement of our five-year goals.

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

### Performance monitoring

Senior management has quarterly business review meetings with the executive directors to monitor and assess our performance against these measures, helping to ensure that we are on track to deliver our targets.

### Performance measurement

At the end of every financial year, our performance is assessed against these measures and this determines employees' annual bonuses right through the organisation. As well as annual targets, our directors are assessed against three-year performance, covering total shareholder return, sustainable dividends and customer service, through long-term incentive plans.

Details of the 2016/17 annual bonus and vested long-term incentive plans for our executive directors are shown on pages 99 to 101 respectively within the remuneration report.

 Read more about [KPIs](#) on pages 31 to 33

The diagram below shows how our strategic themes flow through each planning cycle and help us work towards our vision.



# Our business model

## Systems Thinking

Underpinning the improvements in our operational performance is our drive toward Systems Thinking. This means thinking of our entire network of assets as one big system, and managing it as such.

In this regulatory period, we are investing in our new wholesale operating model and are progressing the roll-out of this unique capability. Our production line model is well established, and we opened our Integrated Control Centre (ICC) in April 2015. This has increasingly become a central hub for planning and control of our operations and proved to be a tremendous asset during our handling of the major incidents we had to address last year.

Our new telemetry backbone has been successfully installed across our estate with only a small number of sites to complete. This provides the 'data highway' between our sites and the ICC, enabling enhanced monitoring and intervention.



Watch our short video at [unitedutilities.annualreport2017.com](http://unitedutilities.annualreport2017.com)

We have full regional production planning up and running for both water production and sludge processing, supported by more enhanced decision-making systems capability at site level.

We are in the final stages of testing of our new maintenance system, providing more effective tasking of field engineering, and we have improved asset availability.

We are using more sensors in our network and better analysing other data, such as weather forecasting, to help reduce costs, improve operational performance and, importantly, prevent issues before they impact the customer.

This is all supported by our digital strategy, in which we have already seen our IT systems overhauled, and for which data and its exploitation becomes central to our thinking. Our Systems Thinking approach is expected to deliver benefits of over £100 million across the 2015-20 regulatory period, which were already built into our business plan assumptions.

## Business insight

### Taking a system-wide approach to sludge treatment

We have a number of sludge treatment facilities across our wastewater production line. These facilities take the sludge produced at our wastewater treatment works, either delivered by road tanker or via a sludge pipe network that connects East Manchester and Liverpool to our strategic facilities in Manchester and Widnes, and treat it to recover renewable energy and make the sludge safe for disposal back to the environment, typically as a fertiliser.

Traditionally, this operation was managed in a reactive manner, with decisions based on little data and made locally at individual sites. Few facilities had the right tools to be able to optimise their activities, meaning we had no capability to plan or manage our sludge operations optimally across the region. This often led to capacity bottlenecks and sub-optimal logistics activities.

The Regional Sludge Operations Management (RSOM) Project has built on the existing technical capabilities available to our Integrated Control Centre (ICC), and site operations teams, to deliver new tools, process and skills. It has also delivered a modelling tool that enables regional throughput and asset utilisation to be optimised through visibility of both current performance and availability of sludge treatment facilities. This enables system-wide choices to be made about where sludge, from across the region, is sent for treatment and energy recovery.

The technical capabilities mean that our Sludge Production Planning team in the ICC is able to visualise and understand the capacity of each of our sludge treatment facilities and the forward looking forecast information from local operations teams. The team then matches production forecasts with available capacity and performance to ensure that decisions about where sludge is sent for treatment are balanced between the costs of sludge transportation and the cost of sludge treatment and disposal and take into account the efficiency of specific energy recovery methods.

Taking this system-wide approach, and optimising our regional operations from our ICC, means we are able to maximise the value of the sludge produced at our wastewater treatment works whilst ensuring that we meet the strict environmental standards for sludge disposal. It also helps maximise the amount of renewable energy generated, an important contribution to helping us meet our carbon reduction targets.



Pictured: dashboard showing real-time gas consumption at our sludge treatment facilities.

# How we measure our performance

## Strategic themes and outcomes

By delivering our strategy to create sustainable value in both the long and short-term, we aim to deliver the following key outcomes for our stakeholders, in line with our strategic themes:



## Our key performance indicators (KPIs)

To help measure our progress on how well we are adding value for our stakeholders and delivering the outcomes described above, we focus on a range of financial and operational KPIs, as defined on the next page. These KPIs are set for the five-year planning period and encompass the important areas of customer service and environmental performance, as well as financial indicators, taking into consideration the interests of all our stakeholders. Strong performance across these KPIs would indicate that our strategy is delivering on our targeted outcomes, helping us on our path to reaching our long-term strategic goals.

Our financial KPIs are the same as for the previous year, and our operational KPIs are the same as for the previous year, with the exception of the KPI relating to the non-household retail part of the business. As this is now under our joint venture, the non-household price control is no longer within our consolidated group and we no longer include this as one of our KPIs.

Our executive bonuses and long-term incentives are closely aligned to our financial and operational performance KPIs, as highlighted in the remuneration report on pages 86 to 109.

# How we measure performance

## Operational KPIs

These operational KPIs feed through from our three strategic themes to deliver the best service to customers, at the lowest sustainable cost, in a responsible manner.

KPI	Target	Performance	Status	Linked to bonus/LTP
<b>The best service to customers</b>				
<b>Wholesale outcome delivery incentive (ODI) composite</b> Net reward/(penalty) accrued across United Utilities' 19 wholesale financial ODIs	Range of +£30 million to -£50 million over 2015-20	<b>2016/17: £6.7 million net reward</b> 2015/16: £2.5 million net reward		Bonus – direct LTP – indirect
<b>Service incentive mechanism – qualitative</b> Ofwat-derived index based on quarterly customer satisfaction surveys, measuring the absolute and relative performance of the 18 water companies. Each company receives a score in the range of zero to five, with five being the highest attainable score	To move towards the upper quartile in the medium-term			Bonus – direct LTP – direct
<b>Service incentive mechanism – quantitative</b> Ofwat-derived composite index based on the number of customer contacts, assessed by type, measuring the absolute and relative performance of the 18 water companies. Each company receives a SIM point total, where the lowest score represents the best performance	To move towards the upper quartile in the medium-term			Bonus – direct LTP – direct
<b>At the lowest sustainable cost</b>				
<b>Totex outperformance</b> Progress to date on delivering our promises to customers within the cumulative 2015-20 wholesale totex final determination allowance	To meet Ofwat's final determination totex allowance	<b>2015-20: On track to meet the final determination allowance</b> Totex new measure for 2015-20 period, hence no prior years' comparators		Bonus – indirect LTP – indirect
<b>Financing outperformance</b> Progress to date on financing expenditure outperformance secured versus Ofwat's industry allowed cost of debt of 2.59 per cent real over the 2015-20 period	To beat Ofwat's industry allowed cost of debt	<b>2015-20: On track to beat Ofwat allowance</b> 2010-15: Exceeded £300 million target		LTP – indirect
<b>Household retail cost to serve</b> Cost to serve in our household retail business compared with Ofwat's revenue allowance	To minimise costs compared with Ofwat's revenue allowance	<b>2016/17: £14 million outperformance</b> 2015/16: £10 million outperformance		Bonus – indirect LTP – indirect
<b>In a responsible manner</b>				
<b>Leakage – average annual leakage</b> Average annual water leakage from our network quantified in megalitres per day	To meet our regulatory leakage target, as set by Ofwat	<b>2016/17: 441MI/d – Met target</b> 2015/16: 463MI/d – Met target 2014/15: 454MI/d – Met target 2013/14: 452MI/d – Met target 2012/13: 457MI/d – Met target		Bonus – indirect
<b>Environment Agency performance assessment</b> Composite assessment produced by the Environment Agency, measuring the absolute and relative performance of the 10 water and wastewater companies across a broad range of areas, including pollution	To be a first quartile performer on a consistent basis			Bonus – indirect
<b>Dow Jones Sustainability Index rating</b> Independent rating awarded using sustainability metrics covering economic, environmental, social and governance performance	To retain 'World Class' rating each year	<b>2016/17: 'World Class'</b> 2015/16: 'World Class' 2014/15: 'World Class' 2013/14: 'World Class' 2012/13: 'World Class'		Bonus – direct

Note 1: Sector best and worst on quantitative SIM based on datashare of 13/18 water companies (using 12 month actuals).

## Financial KPIs

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

KPI	Performance	Status	Feeds into bonus / LTP										
<p><b>Revenue £1,704 million -1.5 per cent</b></p> <p>A definition of revenue is included within the 'Accounting policies' note on page 165</p>	<table border="1"> <tr> <td><b>16/17</b></td> <td><b>£1,704m</b></td> </tr> <tr> <td>15/16</td> <td>£1,730m</td> </tr> <tr> <td>14/15</td> <td>£1,720m</td> </tr> <tr> <td>13/14</td> <td>£1,689m</td> </tr> <tr> <td>12/13</td> <td>£1,636m</td> </tr> </table>	<b>16/17</b>	<b>£1,704m</b>	15/16	£1,730m	14/15	£1,720m	13/14	£1,689m	12/13	£1,636m		Bonus – indirect LTP – indirect
<b>16/17</b>	<b>£1,704m</b>												
15/16	£1,730m												
14/15	£1,720m												
13/14	£1,689m												
12/13	£1,636m												
<p><b>Underlying operating profit £623 million +3.1 per cent</b></p> <p>The underlying operating profit measure excludes from the reported operating profit any restructuring costs and other significant non-recurring items. The group determines adjusted items in the calculation of its underlying operating profit measure against a framework which considers significance by reference to profit before tax, in addition to other qualitative factors such as whether the item is deemed to be within the normal course of business, its assessed frequency of reoccurrence and its volatility which is either outside the control of management and/or not representative of the current year performance. A reconciliation is shown on pages 44 to 45</p>	<table border="1"> <tr> <td><b>16/17</b></td> <td><b>£623m</b></td> </tr> <tr> <td>15/16</td> <td>£604m</td> </tr> <tr> <td>14/15</td> <td>£664m</td> </tr> <tr> <td>13/14</td> <td>£635m</td> </tr> <tr> <td>12/13</td> <td>£604m</td> </tr> </table>	<b>16/17</b>	<b>£623m</b>	15/16	£604m	14/15	£664m	13/14	£635m	12/13	£604m		Bonus – direct LTP – indirect
<b>16/17</b>	<b>£623m</b>												
15/16	£604m												
14/15	£664m												
13/14	£635m												
12/13	£604m												
<p><b>Underlying earnings per share 46.0 pence -3.6 per cent</b></p> <p>This measure deducts underlying net finance expense and underlying taxation from underlying operating profit to calculate underlying profit after tax and then divides this by the average number of shares in issuance during the year. Underlying net finance expense makes adjustments to the reported net finance expense, including the stripping out of fair value movements. Underlying taxation strips out any prior year adjustments, exceptional tax or any deferred tax credits or debits arising from changes in the tax rate from reported taxation. Reconciliations to the underlying measures above are shown on pages 44 to 45</p>	<table border="1"> <tr> <td><b>16/17</b></td> <td><b>46.0p</b></td> </tr> <tr> <td>15/16</td> <td>47.7p</td> </tr> <tr> <td>14/15</td> <td>51.9p</td> </tr> <tr> <td>13/14</td> <td>44.7p</td> </tr> <tr> <td>12/13</td> <td>38.7p</td> </tr> </table>	<b>16/17</b>	<b>46.0p</b>	15/16	47.7p	14/15	51.9p	13/14	44.7p	12/13	38.7p		LTP – indirect
<b>16/17</b>	<b>46.0p</b>												
15/16	47.7p												
14/15	51.9p												
13/14	44.7p												
12/13	38.7p												
<p><b>Dividend per share 38.87 pence +1.1 per cent</b></p> <p>This measure divides total dividends declared by the average number of shares in issuance during the year</p>	<table border="1"> <tr> <td><b>16/17</b></td> <td><b>38.87p</b></td> </tr> <tr> <td>15/16</td> <td>38.45p</td> </tr> <tr> <td>14/15</td> <td>37.7p</td> </tr> <tr> <td>13/14</td> <td>36.04p</td> </tr> <tr> <td>12/13</td> <td>34.32p</td> </tr> </table>	<b>16/17</b>	<b>38.87p</b>	15/16	38.45p	14/15	37.7p	13/14	36.04p	12/13	34.32p		LTP – direct
<b>16/17</b>	<b>38.87p</b>												
15/16	38.45p												
14/15	37.7p												
13/14	36.04p												
12/13	34.32p												
<p><b>Gearing: net debt to RCV 61 per cent +1.0 per cent</b></p> <p>Group net debt (including derivatives) divided by UUW's regulatory capital value (for 2016/17 this uses shadow RCV, adjusted for actual spend, whilst prior years used Ofwat's published RCV in outturn prices as per previous methodology). Our target range is 55 per cent to 65 per cent</p>	<table border="1"> <tr> <td><b>16/17</b></td> <td><b>61%</b></td> </tr> <tr> <td>15/16</td> <td>61%</td> </tr> <tr> <td>14/15</td> <td>59%</td> </tr> <tr> <td>13/14</td> <td>58%</td> </tr> <tr> <td>12/13</td> <td>60%</td> </tr> </table>	<b>16/17</b>	<b>61%</b>	15/16	61%	14/15	59%	13/14	58%	12/13	60%		
<b>16/17</b>	<b>61%</b>												
15/16	61%												
14/15	59%												
13/14	58%												
12/13	60%												

Note 2: For both our Operational and Financial KPIs, where we have declared external targets we assess our performance against these targets. Where there are no externally declared targets we assess our performance against our internal budget, however our internal budget is not disclosed.

Note 3: In some instances the remuneration committee has used metrics with similar names but calculation methodologies which they consider more appropriate for executive remuneration, as set out in the remuneration report on pages 98 to 109.

# Our performance in 2016/17

## Operational performance

### The best service to customers

**Customer service** – sitting at the core of everything we do, our strong focus on customer service has helped us deliver substantial improvements in recent years, becoming the most improved company in the 2010-15 period with a reduction of around 75 per cent in the overall number of customer complaints.

This year we re-energised our approach and have seen another upturn in customer satisfaction. In 2016/17 we delivered our best ever scores under Ofwat's qualitative Service Incentive Mechanism (SIM) measure, placing us above the industry average for the full year, and ending the year as a leading company in the sector. Customer complaints in 2016/17 were considerably lower than last year with a 27 per cent year-on-year reduction and a 55 per cent reduction in the circumstance where an issue is not resolved at first contact.

We introduced a number of innovations over the year, setting new benchmarks for the sector. One of the most successful, Priority Services, provides more targeted support for customers experiencing short or long-term personal or financial difficulties in their lives, with tailored assistance for customers. Since its launch in May 2016, we have seen more than 11,000 customers register for this service, supplementing the wide range of initiatives we already offer customers struggling to pay, in order to help them return to regular payment.

Our new customer website was designed to improve accessibility and ease of use following extensive research and customer engagement, includes web chat services across extended hours, and is mobile-enabled to accommodate customers' increasing use of mobile devices to access day-to-day online services. Additionally, we have recently launched the first fully interactive and real-time customer app in the sector.

Improving customer service will continue to be a key area of focus, and our new management team has identified a range of opportunities to deliver further benefits for our customers.

**Leading North West service provider** – we are consistently ranked third out of ten leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. This covers key attributes such as reputation, trustworthiness and customer service. We are behind only Marks & Spencer and John Lewis, and ahead of seven other major organisations covering utilities, telecoms, media and banking services.

**Robust water supply** – our customers benefit from our robust water supply and demand balance, along with high levels of water supply reliability. Our overall water quality continues to be good, and although our water quality service index has slightly deteriorated from a very good performance in the prior year, it remains above our historical average and we have plans in place to deliver improved performance going forwards. We have consistently delivered a reliable water service, although we experienced some water no-supply incidents in 2016/17. Whilst this is disappointing, our Systems Thinking approach is helping us to respond to these events and avoid them in future.

**Reducing sewer flooding** – we have continued to invest heavily in schemes designed to reduce the risk of flooding of our customers' homes, including incidence-based targeting on areas more likely

to experience flooding and defect identification through CCTV sewer surveys. Our plan for the 2015-20 period includes a target of reducing sewer flooding incidents by over 40 per cent, in line with customers' affordability preferences, and we have made a good start. Our wastewater network will continue to benefit from significant investment going forward, as we aim to help mitigate changing weather patterns likely to result from climate change.

### Key performance indicators:

**Outcome delivery incentives (ODIs)** – we have 19 wholesale financial ODIs and, as outlined last year, the risk is skewed to the downside with 10 attracting a penalty only.

Whilst a number of our ODI measures are susceptible to one-off events and, on the whole, our ODI targets get tougher each year, our performance in the first two years of this regulatory period has now delivered a cumulative net reward of £9.2 million, exceeding our initial expectations. This gives us confidence to narrow our target range for the cumulative net ODI outcome over the 2015-20 period to between plus £30 million and minus £50 million.

In 2016/17 we have achieved another net reward of £6.7 million, exceeding our initial expectations and demonstrating the effectiveness of our planned acceleration of capital expenditure in this regulatory period, alongside our Systems Thinking and innovative approach to the way we operate.

We were particularly pleased this year with the significant improvements made against our leakage targets and have continued to perform well against private sewers and pollution incidents. Our sewer flooding ODI remains challenging as the target becomes increasingly tougher as we progress through this regulatory period. This meant that we received a small penalty this year despite having improved our overall performance compared with the prior year. Our main areas of reward came through our good performance in the areas of leakage, private sewers and pollution, with our main penalty being on reliable water service and water quality service.

**Service incentive mechanism (SIM)** – last year we stated our target was to move towards the upper quartile in the medium-term, and we are particularly pleased with the progress we have made this year, which saw us ending the year as a leading company in our peer group.

*Qualitative:* Ofwat has undertaken the four surveys for 2016/17 and United Utilities has improved its score to 4.42 points, compared with 4.27 points in 2015/16, putting us in joint 6th position for the year out of the 18 water companies, and joint 3rd position out of the 10 companies providing both water and wastewater services. We ended the year with our highest ever score of 4.56 in wave 4, which placed us in equal 3rd position in this wave, and 2nd position out of those providing both water and wastewater services. In particular, customers scored us highly for our billing and wastewater services.

*Quantitative:* the quantitative assessment measures customer contacts, and performance is assessed on both an absolute and relative basis. Whilst relative performance can only be assessed in full following the end of each full financial year when the other companies publish their respective results, on absolute performance for 2016/17, our score of 77 points represents a marked improvement on our 2015/16 score of 95 points, and of the 13 companies who share data on quantitative scores for the full year, this placed us in 4th position out of the 13 and 1st of the 8 water and wastewater companies in this data share.

## Business insight

### Priority Services – giving extra help where it's needed

We recognise that customers, at whatever stage of life they are, may face challenges and need help and support to deal with them. It could be that they've suffered a life event, or have health or financial issues. While we already offered help to customers struggling to pay their bills, we acknowledged that there was more we could do to ensure support was accessible to a wider group of customers perhaps dealing with a broader set of challenges. In response, in May 2016, we launched our special assistance scheme – Priority Services.

Prior to launching the service, we spent valuable time understanding the lessons from similar schemes already operating in the wider marketplace, to make sure we benefited from best practice and external guidance.

Working closely with Age UK, MIND, The Alzheimer's Society and Citizens Advice Bureau, to develop the service, we identified four broad categories, or possible risk factors, of vulnerability:

- › physical – e.g. disability, illness or mental health issues;
- › financial – suffering from financial stress or disadvantaged due to financial circumstances;
- › language – English not first language or those with literacy or numeracy needs; and
- › life events – such as bereavement or job loss.

We appreciate that customers may experience one, or a combination of circumstances, so our Priority Services scheme is designed to understand their particular needs in order to provide the right help.

From the start, we felt this was a proposition which required the personal touch, so customers who register for Priority Services are looked after by a specialist team.

Through Priority Services, we can help customers in a number of ways:

- › allow customers to nominate a carer or family member to discuss their account;
- › 'knock and wait' alert so we know that if we do call at their home, that we need to give them extra time to get to the door;
- › a text relay service;
- › braille, large print, talking bills;
- › a password scheme;
- › translation services;

- › dedicated webchat for those more confident online;
- › help and notification during water and wastewater network issues, such as providing bottled water for those who need it when we have water supply problems;
- › support for dialysis patients;
- › water meter help; and
- › a range of broader financial assistance schemes.

The year ahead will see us launching Priority Ambassadors, equipping our volunteer employees with training and materials to enable them to encourage more sign-ups in their own communities. We are training field-based employees and third party contractors to better spot and support those customers who need extra support.

There are now 30,000 customers registered for Priority Services across the North West.



Watch our short video on priority services at [unitedutilities.annualreport2017.com/strategic-report/our-performance-in-201617/operational-performance](http://unitedutilities.annualreport2017.com/strategic-report/our-performance-in-201617/operational-performance)

# Our performance in 2016/17

## At the lowest sustainable cost

**Power and chemicals** – 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. In addition to the electricity we generate from bioresources, we are developing other renewable energy facilities. This is primarily in the area of solar, where we have invested £45 million in the first two years of the 2015-20 period, contributing towards our expected investment of over £100 million across the five-year period. We have also substantially locked in our power commodity costs across 2015-20, providing greater cost certainty for the regulatory period.

**Proactive network management** – through our Systems Thinking approach we are more proactive in the management of our assets and networks. We aim to improve our predictive modelling and forecasting through better use of sensors in our network and better analysis of other data, such as weather forecasting, to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving our performance and efficiency.

**Debt collection** – our region suffers from high levels of income deprivation and we offer wide-ranging schemes to help customers struggling to pay, including our trust fund into which we paid a £5 million contribution in 2016/17. Notwithstanding our industry-leading debt management processes, deprivation remains the principal driver of our higher than average bad debt and cost to serve and we expect this to continue to be a challenging area for us.

Reflecting our ongoing focus on bad debt through our new customer facing management team and the penetration of our affordability schemes, our household bad debt expense has reduced to 2.5 per cent of regulated revenue from 3.0 per cent last year.

**Pensions** – United Utilities has taken progressive steps to de-risk its pension provision. The group had an IFRS retirement benefit surplus of £248 million as at 31 March 2017, compared with a surplus of £275 million as at 31 March 2016. Further details of the group's pension provision are provided in the pensions section on page 43.

Ongoing formal consultations continue regarding proposed changes to the group's pension schemes.

**Capital delivery and regulatory commitments** – we are strongly focused on delivering our commitments efficiently and on time, and have a robust commercial capital delivery framework in place. Across the 2015-20 regulatory period, we are working with a single engineering partner and four design and construction partners to deliver our regulatory capital investment programme of c£3.6 billion. We are involving our partners much earlier in project definition and packaging projects by type, geography and timing in order to deliver efficiencies. Projects are allocated on an incentive or competitive basis leading to our partners presenting a range of solutions, innovations and pricing.

We have continued the planned acceleration of our 2015-20 investment programme in order to improve services for customers and deliver early operational and environmental benefits. Regulatory capital investment in 2016/17, including £148 million of infrastructure renewals expenditure, was £804 million, in line with our expectations. This, combined with £799 million invested in 2015/16, brings our total spend to around £1.6 billion of our planned £3.6 billion capital investment across the 2015-20 period.

We are also driving more effective and efficient delivery of our capital programme and applying a tougher measurement mechanism to our Time, Cost and Quality index (TCQi) score for this regulatory period. Despite this tougher approach, our TCQi score remains high at 93 per cent which represents a very good performance, improving from what was already a good performance at 90 per cent in 2015/16.

## Key performance indicators:

**Financing outperformance** – the low cost of debt we have already locked in places United Utilities in a strong position to deliver our target for the 2015-20 period of minimising our cost of debt compared to Ofwat's industry allowed cost.

**Total expenditure (totex) performance** – although our totex allowance for the 2015-2020 period is challenging, we are implementing a range of initiatives and are confident of meeting our target of delivering our promises to customers within the cumulative 2015-20 wholesale totex final determination allowance. Progress in the first two years has been good and we remain on track to meet the five-year target.

**Domestic retail cost to serve** – overall, it will be very challenging to meet the regulatory assumptions for domestic retail costs. This is primarily due to Ofwat's price review methodology at PR14 which made no allowance for inflation in the domestic retail business and, in our view, made insufficient allowance for dual service (water and wastewater) companies. The regulatory assumptions for domestic retail costs become progressively tougher as we move through the 2015-20 period. Our target is to minimise our costs compared with Ofwat's revenue allowance and, despite the challenging target, we have delivered a good performance in 2016/17, outperforming this year's revenue allowance by around £14 million.

## Business insight

# Design for Manufacture and Assembly – a new approach

United Utilities has a significant and challenging capital programme to deliver. Our wholesale operating model/Systems Thinking approach is a radically different way of working and involves investment in a comprehensive set of operating capabilities.

New thinking is not just limited to the way we run our business, it extends to how we design and build our assets, embracing the innovation available from the supply chain.

Traditional on-site manufacturing can be noisy and disruptive for our customers and neighbours and it can be expensive to remove the inherent safety risks with being on busy construction sites. Designing and building off-site in a factory reduces our customer disruption and reduces the on-site safety risk.

One innovation from the supply chain is Design for Manufacture and Assembly (DfMA). DfMA is a new way of thinking about how we design and build new assets. It involves the digital design and prefabrication of a significant proportion of a project off-site. We selected partners that had invested in these techniques and our target is for more than 75 per cent of our projects in AMP6 to employ this approach – aiming to save 10 per cent over traditional costs.

DfMA delivers improvements in safety, quality and maintenance. It eliminates resource waste and reduces on-site build time. We are targeting a total saving of 15,000 man days over this five-year period, and have used DfMA across many areas – from stairways to service reservoirs and from tanks to treatment processes. All have been designed digitally, built in a safer factory environment and delivered and assembled on-site.

DfMA supports product standardisation and we are increasingly using common designs across our asset base, saving duplicated design costs and offering production and maintenance efficiencies. We are developing industry-leading standard products accessible through a digital library for our supply chain partners so we guarantee consistency and standardisation.

Other water companies are using DfMA and we compare favourably to them in our DfMA strategy, ambition and performance. Whilst we are encouraging the use of DfMA on the majority of our projects, our showcase DfMA project is our £200 million modernisation programme at our biggest wastewater treatment works, Davyhulme in Manchester. Here, 35 per cent of the construction project spend is in DfMA – including 4,000 pre-cast panels assembled on site, halving the duration compared to the traditional approach.



Pictured: After constructing the base of the settlement tank at Davyhulme, the pre-cast panels go up in only four days. This has halved the typical site construction schedule.

# Our performance in 2016/17

## In a 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 in its strategic decision-making. Our environmental and sustainability performance across a broad front has received external recognition. Earlier in the 2016/17 financial year, United Utilities retained its World Class rating in the Dow Jones Sustainability Index for the ninth consecutive year, again achieving industry leading performance status in the multi-utility/water sector. Retaining 'World Class' status for this length of time is a significant achievement, particularly as the assessment standards continue to increase and evolve. In addition, at the Finance for the Future Awards in October 2016, United Utilities won the international Communicating Integrated Thinking award, following on from the PwC 2015 Building Public Trust Awards in which United Utilities was selected as joint winner for Excellence in Reporting in the FTSE 100.

**Leakage** – we have a strong, year round, operational focus on leakage, alongside our network resilience improvements and the implementation of a range of initiatives, such as active pressure management. This delivered a particularly good performance against our leakage targets in 2016/17, delivering our largest ODI reward in this area.

**Environmental performance** – this is a high priority for United Utilities and we were encouraged to have been awarded Industry Leading Company status in the Environment Agency's latest performance metrics, as described in the KPIs section below.

**Carbon footprint** – we are committed to reducing our carbon footprint and increasing our generation of renewable energy. Our carbon footprint has reduced by 22 per cent over the last 10 years. Our renewable energy production in 2016/17 was 149 GWh, representing 18 per cent of our electricity consumption in the year. This represents good progress over the last few years, up from 13 per cent in 2012/13, and we are implementing plans to significantly increase self-generation over the next few years.

**Employees** – we continue to work hard to engage all of our employees in the transformation of the group's performance. Employee engagement was high at 89 per cent this year, broadly in line with last year on a normalised basis as we amended the question structure slightly. We remain focused on maintaining high levels of employee engagement.

We have been successful in attracting and retaining people and have continued to expand our apprentice and graduate programmes for 2016/17. We now have a total of 64 graduates and 119 apprentices across the business. Our investment in recruiting graduates and apprentices is already benefiting the company, with 122 of them now having secured permanent roles across our business.

Over the last year, we have continued our sustained focus on health, safety and wellbeing. In this period we retained our Gold award status with the Royal Society for the Prevention of Accidents as well as the top place ranking on the Dow Jones Sustainability Index. Following a four-day audit, we were also awarded the UK Workplace Wellbeing Charter. Our contractor accident frequency rate is at its lowest ever at 0.087 accidents per 100,000 hours. For the same period, our

employee accident frequency rate has increased to 0.196 accidents per 100,000 hours, compared with a rate of 0.104 in 2015/16. We recognise that we still have more to do, and health and safety will continue to be a significant area of focus as we strive for continuous improvement.

**Communities** – we continue to support partnerships, both financially and in terms of employee time through volunteering, with other organisations across the North West. Our Catchment Wise programme helps to tackle water quality issues in lakes, rivers and coastal waters across the North West, and our Beachcare employee volunteering scheme helps to keep our region's beaches tidy. We continue to support local communities, through contributions and schemes such as providing debt advisory services and our Community Fund, offering grants to local groups impacted by our capital investment programme.



**Pictured:** Employee volunteering, such as helping with local clean-ups, is an important part of how we support our communities.

## Key performance indicators:

**Leakage** – although leakage is included within our outcome delivery incentives, we intend to continue publishing our leakage position separately, with it being an important measure from a corporate responsibility perspective. We delivered an excellent performance in 2016/17 and have again met our regulatory leakage target of 463 megalitres per day.

**Environmental performance** – on the Environment Agency's latest annual assessment, published in July 2016, we were awarded Industry Leading Company status across the range of operational metrics. This indicates we were in second position amongst the ten water and sewerage companies and aligns with our medium-term goal of being a first quartile company on a consistent basis.

**Corporate responsibility** – United Utilities has a strong focus on operating in a responsible manner and is the only UK water company to have a World Class rating as measured by the Dow Jones Sustainability Index. In 2016/17, United Utilities retained its World Class rating for the ninth consecutive year.

## Business insight

### Adapting to climate change

The water sector is one of the most impacted by climate change and this presents both risks and opportunities in the short, medium and long-term.

Consequently, it features predominantly in our strategic thinking and plans. Its impacts, whether relating to water resources or flooding, are considered carefully by the board as highlighted in the corporate governance report, on pages 82 to 84, and management teams as highlighted in the planning section on pages 26 to 29.

Throughout this report, we comment on what climate change means to us and how we are responding. We have a well-established framework for risk management – climate change is one of many risks to our business so it is managed in the same way as any other; see pages 46 to 49 for our risk management approach. Comprehensive details can be found in our annual disclosure to the CDP and our 2015 adaptation report to government where we disclose our climate-related risks and management plans. Both of these can be found at: [unitedutilities.com/corporate](http://unitedutilities.com/corporate)

Predicted changes to rainfall patterns affecting water quantity and increasing flooding risk from sewers are factored into our strategic planning processes.

Our 25-year water resource management planning takes into account the latest climate change models, including those which contain scenarios for 2°C of global warming. This process means we invest appropriately to ensure the resilience of water supplies, balancing customer demand with the environmental impact of abstraction. And, for times of rainfall shortage, we have a comprehensive drought plan.

To manage situations of too much water, we've changed the operation of some reservoirs to store increased volumes of rainfall. We are also piloting predictive ways to manage our wastewater network as highlighted on page 30. When severe rainfall events are predicted, our aim is to proactively reconfigure

asset operation to handle the additional volume of water, either eliminating or reducing the impact to our customers and assets.

We continue to focus on climate change mitigation, targeting an emissions reduction of 50 per cent by 2020 from a 2006 baseline. Our self-generation of renewable energy is now at 18 per cent with a target to increase this to 35 per cent by 2020, subject to good projected returns. This enhances security of energy supply, provides a new income stream and reduces energy bills.

Efforts continue to reduce our overall energy consumption given c70 per cent of carbon emissions come from electricity used, primarily to power treatment works, where a further 20 per cent of emissions arise from treatment processes. More information can be found within our Carbon section on page 111. In addition, we have embraced innovative practices such as dynamic demand, being the first water company to sign up for National Grid's system to switch equipment off and on in response to changes in electricity supply and demand nationwide, receiving payment for doing so.

The response to climate change is a shared problem requiring shared solutions. That is why, for example, we founded Business in the Community's Water Taskforce, using an existing business network to encourage organisations to take action to address the water management challenges of too much, too little and water of the right quality. For more information on the Taskforce visit [bitc.org.uk](http://bitc.org.uk)

Each year, we report performance against a set of climate change metrics covering carbon targets, water supply security and flooding. These can be found in this report and on our corporate responsibility webpages. Our belief is that in reporting what we are doing to address both climate change mitigation and adaptation, and by sharing our progress, we can encourage others to work with us to act responsibly and take action.



Details of our 25-year water resource plan and corporate responsibility can be found at [corporate.unitedutilities.com/corporate-responsibility](http://corporate.unitedutilities.com/corporate-responsibility)

Pictured: Flooding at our water treatment works in Keswick following Storm Desmond.



# Our performance in 2016/17

## Financial performance

### Highlights

	Year ended	
	31 March 2017	31 March 2016
Continuing operations		
Revenue	<b>£1,704.0m</b>	£1,730.0m
Underlying operating profit <sup>(1)</sup>	<b>£622.9m</b>	£604.1m
Operating profit	<b>£605.5m</b>	£567.9m
Total dividend per ordinary share (pence)	<b>38.87p</b>	38.45p
RCV gearing <sup>(2)</sup>	<b>61%</b>	61%

(1) Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on pages 44 to 45.

(2) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's RCV (outturn prices).

## Revenue

Revenue was down £26 million, at £1,704 million, reflecting the impact of our Water Plus JV, which completed on the 1 June 2016, partly offset by our allowed regulatory revenue changes.

With regard to Ofwat's revenue correction mechanism, relating to the 2014/15 financial year, we have £9.5 million to return to customers. As we have previously indicated, we propose to return the £9.5 million to customers through revenue reductions of c£3 million in 2017/18, c£3 million in 2018/19 and c£3 million in 2019/20 to help aid a smoother bill profile.

Separately, consistent with Ofwat's annual wholesale revenue forecasting incentive mechanism (WRFIM), we will also be reducing 2017/18 revenue by £7 million as actual volumes in 2015/16 were higher than our assumptions, increasing revenue by 0.4 per cent.

## Operating profit

Underlying operating profit at £623 million was £19 million higher than last year. This reflects our allowed regulatory revenue changes, a reduction in infrastructure renewals expenditure, an improvement in our bad debt charges and a small reduction in the remaining cost base, partly offset by the accounting impact of our Water Plus JV. The JV completed on 1 June 2016 and, from that date, its contribution is no longer included within operating profit and is, instead, included within the share of profits of joint ventures line in the income statement. However, as expected, due to start-up costs, our share of 2016/17 losses of the Water Plus JV was around £2 million.

Reported operating profit increased by £38 million, to £606 million, reflecting the increase in underlying operating profit, along with a reduction in adjusted items. Adjusted items for 2016/17 amounted to £17 million, £10 million of which related to restructuring costs. Adjusted items in the prior year amounted to £36 million, £25 million of which related to the water quality incident in summer 2015.

## Investment income and finance expense

The underlying net finance expense of £237 million was £36 million higher than last year, mainly due to the impact of higher RPI inflation on the group's index-linked debt, particularly on the portion of index-linked debt with a three-month lag. Interest on non index-linked debt of £108 million was £4 million lower than last year, due to the lower rates locked in on our interest rate swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £81 million, compared with a net charge of £38 million last year. As at 31 March 2017, the group had approximately £3.6 billion of index-linked debt at an average real rate of 1.3 per cent.

The higher RPI inflation charge compared with last year contributed to the group's average underlying interest rate of 3.8 per cent being higher than the rate of 3.4 per cent for the year ended 31 March 2016. The average underlying interest rate represents the underlying net finance expense divided by average debt.

Reported net finance expense of £189 million was lower than the £219 million expense in 2015/16. This £30 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £26 million loss in 2015/16 to a £24 million gain in 2016/17. The fair value gain in the current year is due to the net receipts on swaps and debt under fair value option and gains on our electricity swap portfolio due to an increase in the market price of electricity. Losses in the prior year were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by Ofwat at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015-20 regulatory period.

## Profit before tax

Underlying profit before tax was £389 million, £19 million lower than last year, as the £19 million increase in underlying operating profit was more than offset by the £36 million increase in underlying net finance expense. This underlying measure reflects the adjusting items, as outlined in the operating profit section above, and other items such as fair value movements in respect of debt and derivative instruments, as outlined in the underlying profit measures table on pages 44 to 45.

Reported profit before tax significantly increased by £89 million to £442 million, due in most part to fair value movements and the increase in reported operating profit, as well as a £22 million profit on disposal of the non-household retail business.

## Tax

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £140 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees such as water abstraction charges.

In 2016/17, we paid corporation tax of £42 million, which represents an effective cash tax rate on underlying profits of 11 per cent, which is 9 per cent lower than the headline rate of corporation tax of 20 per cent. Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes fair value movements on debt and derivative instruments and thereby enables a medium-term cash tax rate forecast. We would expect the average cash tax rate on underlying profits through to the end of the current regulatory period in March 2020 to be around 15 per cent. The key risk to sustaining this rate is any unexpected changes in tax legislation or practice and, as necessary, we would actively engage with the relevant authorities in order to manage this risk.

The current tax charge was £54 million in 2016/17, compared with £53 million in the previous year. There were current tax credits of £23 million in 2016/17 and £9 million in 2015/16, following agreement of prior years' tax matters; in addition to UK tax, the current year figure also included the release of a provision in relation to agreed historic overseas tax matters.

For 2016/17, the group recognised a deferred tax charge of £28 million, compared with a charge of £19 million for 2015/16. In addition, in 2016/17 the group recognised a deferred tax charge of £7 million relating to prior years' tax matters, compared with a charge of £6 million in 2015/16. In 2016/17, the group also recognised a deferred tax credit of £58 million relating to the enacted reduction in the headline rate of corporation tax from 18 per cent to 17 per cent from 1 April 2020. This compares to a deferred tax credit of £112 million in 2015/16 when the enacted reduction in the headline rate of corporation tax from 1 April 2020 was reduced from 20 per cent to 18 per cent.

The total tax charge for 2016/17 was £9 million as compared to a total tax credit of £44 million for 2015/16, the main difference being the £54 million reduction in the deferred tax credit relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium-term.

## Profit after tax

Underlying profit after tax of £313 million was £12 million lower than last year, principally reflecting the £19 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £434 million, compared with £398 million in the previous year, as the £89 million increase in the reported profit before tax was partly offset by the £53 million higher tax charge.

## Earnings per share

Underlying earnings per share decreased from 47.7 pence to 46.0 pence. This underlying measure is derived from underlying profit after tax. Basic earnings per share increased from 58.3 pence to 63.6 pence, for the same reasons that increased profit after tax.

## Dividend per share

The board has proposed a final dividend of 25.92 pence per ordinary share in respect of the year ended 31 March 2017. Taken together with the interim dividend of 12.95 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2016/17 of 38.87 pence. This is an increase of 1.1 per cent, compared with the dividend relating to last year, in line with the group's dividend policy of targeting a growth rate of at least RPI inflation each year through to 2020. The inflationary increase of 1.1 per cent is based on the RPI element included within the allowed regulated revenue increase for the 2016/17 financial year (i.e. the movement in RPI between November 2014 and November 2015).

The final dividend is expected to be paid on 4 August 2017 to shareholders on the register at the close of business on 23 June 2017. The ex-dividend date is 22 June 2017.

In light of the Financial Reporting Lab's report entitled 'Disclosure of dividends – policy and practice', which provided best practice guidance, we enhance our dividend policy disclosure, as outlined below.

**Dividend policy** – a growth rate target of at least RPI inflation each year through to 2020.

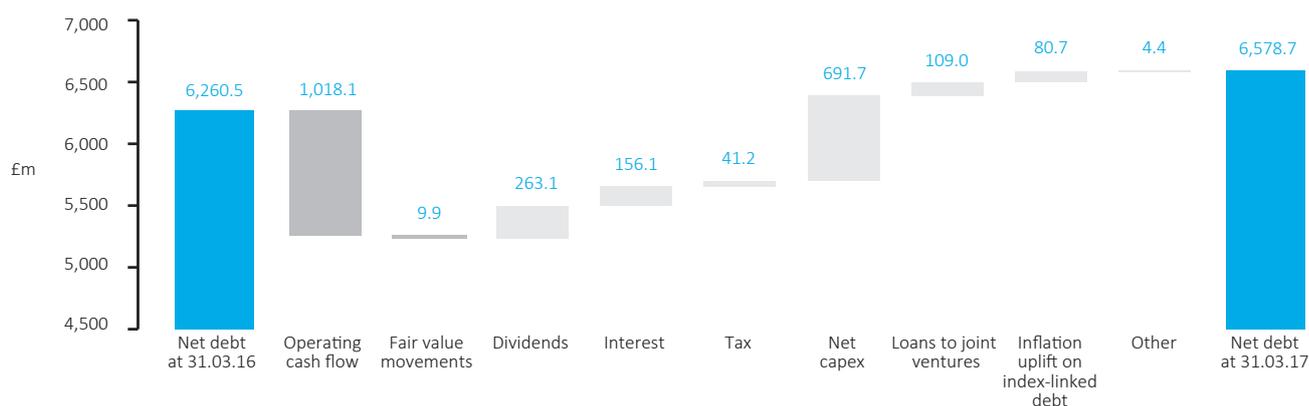
**Policy period** – the dividend policy aligns with the five-year regulatory period which runs from 1 April 2015 to 31 March 2020.

**Policy approval process** – the dividend policy was considered and approved by the United Utilities group board in January 2015, as part of a comprehensive review of the 2015-20 regulatory final determination in the context of a detailed business planning process, with due regard for the group's financial metrics, credit ratings and long-term financial stability, and is reviewed at least annually.

**Distributable reserves** – as at 31 March 2017, the company had distributable reserves of £3,184 million. The total external dividends relating to the 2016/17 financial year amounted to £265 million. The company distributable reserves support over 12 times this annual dividend.

**Financing headroom** – supporting the group's cash flow, United Utilities adopts a funding/liquidity headroom policy of having available resources to cover the next 15-24 months of projected cash outflows.

## Summary of net debt movement



# Our performance in 2016/17

**Cash flows from subsidiaries** – the directors consider that the group’s principal operating subsidiary, United Utilities Water Limited (UUV), has sufficient resources to pay dividends to United Utilities Group PLC for the duration of the current dividend policy period to support the external payment of dividends to shareholders.

**Financial stability** – the water industry has invested significant capital since privatisation in 1989 to improve services for customers and provide environmental benefits, a large part of which is driven by legislation. Water companies have typically raised borrowings to help fund the capital investment programme. Part of total expenditure is additive to the regulatory capital value, or RCV, on which water companies earn a return allowed by the economic regulator, Ofwat. RCV gearing is useful in assessing a company’s financial stability in the UK water industry and is one of the key credit metrics that the credit rating agencies focus on. United Utilities has had a relatively stable RCV gearing level over the last five years, always comfortably within its target range of 55 per cent to 65 per cent, supporting a solid A3 credit rating for UUV with Moody’s. RCV gearing at 31 March 2017 was 61 per cent and the movement in net debt is outlined in the cash flow section below.

**Dividend sustainability** – in approving the policy, the board is satisfied that across the current regulatory period, the projected dividend is adequately covered by underlying profit after tax. Separately, the executive directors’ long-term remuneration plan is directly linked to a measure of sustainable dividends. Whilst specific targets are not disclosed in advance, for commercial sensitivity reasons, there is a major focus on the creation of strong earnings that ensure the sustainability of dividends.

**Viability statement** – the dividend policy is underpinned by the group’s long-term viability statement (contained within the group’s annual report and financial statements). Assurance supporting this statement is provided by the review of: the group’s key financial measures; the key credit financial metrics; the group’s liquidity position; the contingent liabilities of the group; and the key risks of the group together with the associated mitigating actions.

**Annual dividend approval process** – the group places significant emphasis on strong corporate governance, and before declaring interim and proposing final dividends, the United Utilities group board undertakes a comprehensive assessment of the group’s key financial metrics.

## Policy sustainability

### 2015-20

- › The policy is considered by the board to be robust to reasonable changes in assumptions, such as inflation, opex, capex and interest rates
- › Extreme economic, regulatory, political or operational events, which could lead to a significant deterioration in the group’s financial metrics during the policy period, may present risks to policy sustainability

### 2020-25

- › A dividend policy for the 2020-25 period will be formulated after Ofwat announces the outcome of the regulatory price review (currently expected in December 2019)

## Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2017 was £821 million, compared with £686 million in the previous year. This increase mainly reflects a switch between cash generated from operating activities and cash used in investing activities largely due to the accounting treatment of our Water Plus JV. The group’s net capital expenditure was £692 million, principally in the

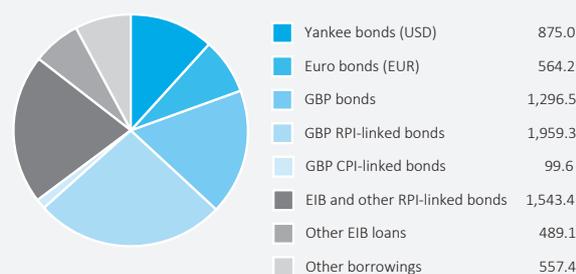
regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS. Cash flow capex differs from regulatory capex, since regulatory capex is based on capital work done in the period, rather than actual cash spent.

Net debt including derivatives at 31 March 2017 was £6,579 million, compared with £6,261 million at 31 March 2016. This increase reflects accelerated regulatory capital expenditure, payments of dividends, interest and tax, the inflationary uplift on index-linked debt and loans to joint ventures, partly offset by operating cash flows.

## Fair value of debt

The group’s gross borrowings at 31 March 2017 had a carrying value of £7,385 million. The fair value of these borrowings was £8,603 million. This £1,218 million difference principally reflects the significant fall in real interest rates, compared with the rates at the time we raised a portion of the group’s index-linked debt. This difference has increased from £483 million at 31 March 2016, due primarily to a decrease in credit spreads.

## Gross debt – total carrying value £7,384.5m



## Debt financing and interest rate management

Gearing, measured as group net debt divided by UUV’s shadow (adjusted for actual spend) regulatory capital value, was 61 per cent at 31 March 2017. This is the same gearing as at 31 March 2016 and remains comfortably within our target range of 55 per cent to 65 per cent.

UUV has long-term credit ratings of A3/BBB+ and United Utilities PLC (UU PLC) has long-term credit ratings of Baa1/BBB- from Moody’s Investors Service (Moody’s) and Standard & Poor’s (S&P) Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. Moody’s has the group’s ratings on a stable outlook, whereas S&P has the group’s ratings on a positive outlook.

The group has access to the international debt capital markets through its €7 billion euro medium-term note (EMTN) programme. The EMTN programme does not represent a funding commitment, with funding dependent on the successful issue of the notes.

Cash and short-term deposits at 31 March 2017 amounted to £248 million. Over 2015-20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our five-year investment programme, and we have now raised over £1.7 billion of this requirement.

In April 2016, UUV signed a £250 million index-linked term loan facility with the EIB to support the delivery of UUV’s AMP6 investment programme. As at 31 March 2017, £75 million had been drawn down.

This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and is the first tranche of an anticipated £500 million funding package for AMP6 from the EIB, with the second tranche expected to be made available for signature later in the AMP.

In June 2016, UUW's financing subsidiary, United Utilities Water Finance PLC (UUWF), raised c£76 million of term funding, via the issue of €30 million and HKD600 million private placement notes, both with a 15-year maturity, off our EMTN programme. In September 2016, UUWF raised c£53 million of term funding, via the issue of 12-year and 20-year private placement notes, in RPI-linked form, off the group's EMTN programme, at the group's best ever real interest rates. In the second half of 2016/17, UUWF raised a further c£172 million, via the issue of 15-year and 20-year private placement notes, in index-linked form, off our EMTN programme. In response to Ofwat's decision to transition away from RPI inflation linkage, £100 million of this index-linked funding was CPI-linked, these being the first ever CPI-linked notes issued by a UK utility.

In addition, since September 2016, the group has agreed £100 million of new or replacement five-year committed bank facilities and extended a further £100 million for an initial term of five years. The group has headroom to cover its financing needs into 2019.

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 provides a natural hedge to assets and earnings. At 31 March 2017, approximately 55 per cent of the group's net debt was in index-linked form, representing around 34 per cent of UUW's regulatory capital value, with an average real interest rate of 1.3 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile, which is around 20 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, the debt is generally swapped to create a floating rate sterling liability for the term of the debt. To manage exposure to medium-term interest rates, the group fixes underlying interest costs on nominal debt out to 10 years on a reducing balance basis. This is supplemented by fixing substantially all remaining floating rate exposure across the forthcoming regulatory period around the time of the price control determination.

In line with this, the group has fixed interest costs for substantially all of its floating rate exposure over the 2015-20 period, locking in an average annual interest rate of around 3.6 per cent (inclusive of credit spreads).

## Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. The group's €7 billion EMTN programme provides further support.

Available headroom at 31 March 2017 was £699 million based on cash, short-term deposits, committed bank facilities and the undrawn portion of the signed EIB term loan facilities, net of short-term debt as well as committed facilities and term debt falling due within 12 months.

United Utilities 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. United Utilities' cash is held in the form of short-term money market deposits with prime commercial banks.

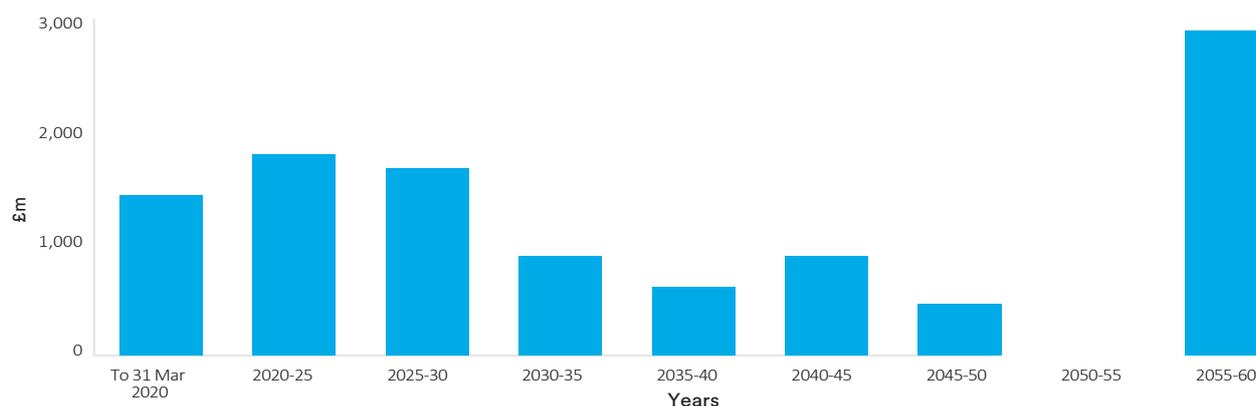
United Utilities operates a bilateral, rather than a syndicated, approach to its core relationship banking facilities. This approach spreads maturities more evenly over a longer time period, thereby reducing refinancing risk and providing the benefit of several renewal points rather than a large single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

## Pensions

As at 31 March 2017, the group had an IAS 19 net pension surplus of £248 million, compared with a net pension surplus of £275 million at 31 March 2016. This £28 million reduction mainly reflects the impact of a decrease in credit spreads. In contrast, the scheme specific funding basis does not suffer from volatility due to inflation and credit spread movements as it uses a fixed inflation assumption via a blend of the inflation market hedge and the inflation funding mechanism and a prudent, fixed credit spread assumption. Therefore, the recent inflation and credit spread movements have not had a material impact on the deficit calculated on a scheme specific funding basis or the level of deficit repair contributions.

Further detail on pensions is provided in note 18 ('Retirement benefit surplus') of these condensed consolidated financial statements.

## Term debt maturity per regulatory period\*



\*Future repayments of index-linked debt include inflation based on an average annual RPI rate of 3% and an average annual CPI rate of 2%.

# Our performance in 2016/17

## Guide to Alternative Performance Measures (APMs)

The underlying profit measures in the table opposite represent the group's alternative performance measures (APMs) under the definition given by the European Securities and Markets Authority (ESMA). These measures are linked to the group's financial performance as reported under International Financial Reporting Standards (IFRSs) as adopted by the European Union in the group's consolidated income statement, which can be found on page 124. As such, they represent non-GAAP measures.

These APMs are reviewed internally by management and reported to the board, and have been presented in order to provide a more representative view of business performance. The group determines adjusted items in the calculation of its underlying measures against a framework which considers significance by reference to profit before tax, in addition to other qualitative factors such as whether the item is deemed to be within the normal course of business, its assessed frequency of reoccurrence and its volatility which is either outside the control of management and/or not representative of current year performance.

### Alternative performance measure

<b>Water quality incident</b>	A significant water quality incident occurred in the year ended 31 March 2016, the likes of which management would not expect to occur on a frequent basis. As such, this was not considered part of the normal course of business.
<b>Flooding incidents</b>	Two significant flooding incidents in the year ended 31 March 2016 caused extensive damage to localised parts of our infrastructure, resulting in significant levels of remedial operating expenditure and a large claim under the group's insurance cover. Management's view is that these were significant and infrequent events and as such, were not part of the normal course of business.
<b>Non-household retail market reform</b>	The group has incurred significant costs since the year ended 31 March 2015 in preparation of the non-household retail market opening to competition in April 2017. This represents a one-off event and as such, is not considered part of the normal course of business.
<b>Restructuring costs</b>	The group has incurred restructuring costs in the past in relation to a number of discrete underlying events which can cause volatility in the reported results. Management adjusts internally for these costs to provide an underlying view of performance which it views as being more representative of the normal course of business and more comparable period to period.
<b>Net fair value losses on debt and derivative instruments</b>	Fair value movements on debt and derivatives can be both very significant and volatile from one period to the next. These movements are determined by macro economic factors which are outside the control of management and these instruments are purely held for funding and hedging purposes (not for trading purposes). Taking these factors into account, management believes it is useful to adjust for this to provide a more representative view of performance.
<b>Interest on swaps and debt under fair value option</b>	Net fair value losses on debt and derivative instruments includes interest on swaps and debt under fair value option. In adjusting for the former, it is appropriate to add back interest on swaps and debt under fair value option to provide a view of the group's cost of debt which is better aligned to the return on capital it earns through revenue.
<b>Net pension interest (income)/expense</b>	This item can be very volatile from one period to the next and it is a direct function of the extent to which the pension scheme is in an accounting deficit or surplus position. Management believes it is useful to adjust for this to provide a more representative view of performance which is better aligned to the return on capital it earns through revenue.
<b>Capitalised borrowing costs</b>	The accounting standards allow for the capitalisation of borrowing costs in the cost of qualifying assets. Management believes it is appropriate to adjust for these significant costs to provide a representative cost of borrowings and current year performance which is better aligned to the return on capital it earns through revenue.
<b>Profit on disposal of business</b>	This relates to the disposal of the group's non-household retail business during the year ended 31 March 2017 which represents a significant one-off event and as such is not considered part of the normal course of business.
<b>Deferred tax credit-change in tax rate</b>	The deferred tax impact from changes to the corporation tax rate announced by HMRC represent both significant and volatile impacts which are outside the control of management. Management adjusts for this to provide a more representative view of current year performance.
<b>Agreement of prior years' tax matters</b>	The agreement of prior years' tax matters can be significant, volatile and often related to the final settlement of numerous prior year periods. Management adjusts for this to provide a more representative view of current year performance.
<b>Tax in respect of adjustments to underlying profit before tax</b>	Management adjusts for the tax impacts of the above adjusted items to provide a more representative view of current year performance.

## Underlying profit

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
<b>Operating profit</b>		
<b>Operating profit per published results</b>	<b>605.5</b>	567.9
Water quality incident	-	24.8
Flooding incidents (net of expected insurance proceeds)	1.5	(0.6)
Business retail market reform <sup>(1)</sup>	5.8	11.1
Restructuring costs	10.1	0.9
<b>Underlying operating profit</b>	<b>622.9</b>	604.1
<b>Net finance expense</b>	<b>£m</b>	<b>£m</b>
Finance expense	(202.7)	(224.4)
Investment income	13.7	5.0
<b>Net finance expense per published results</b>	<b>(189.0)</b>	(219.4)
Adjustments:		
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest income	(10.2)	(3.1)
Adjustment for capitalised borrowing costs	(29.2)	(21.3)
<b>Underlying net finance expense</b>	<b>(237.3)</b>	(201.0)
<b>Profit before tax</b>	<b>£m</b>	<b>£m</b>
<b>Share of profits of joint ventures</b>	<b>3.8</b>	5.0
<b>Profit before tax per published results</b>	<b>442.4</b>	353.5
Adjustments:		
Water quality incident	-	24.8
Flooding incidents	1.5	(0.6)
Business retail market reform <sup>(1)</sup>	5.8	11.1
Restructuring costs	10.1	0.9
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest income	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Profit on disposal of business	(22.1)	-
<b>Underlying profit before tax</b>	<b>389.4</b>	408.1
<b>Profit after tax</b>	<b>£m</b>	<b>£m</b>
<b>Underlying profit before tax</b>	<b>389.4</b>	408.1
Reported tax (charge)/credit	(8.5)	44.0
Deferred tax credit – change in tax rate	(58.2)	(112.5)
Agreement of prior years' tax matters	(15.5)	(3.4)
Tax in respect of adjustments to underlying profit before tax	6.2	(10.9)
<b>Underlying profit after tax</b>	<b>313.4</b>	325.3
<b>Earnings per share</b>	<b>£m</b>	<b>£m</b>
Profit after tax per published results (a)	433.9	397.5
Underlying profit after tax (b)	313.4	325.3
Weighted average number of shares in issue, in millions (c)	681.9m	681.9m
Earnings per share per published results, in pence (a/c)	63.6p	58.3p
<b>Underlying earnings per share, in pence (b/c)</b>	<b>46.0p</b>	47.7p
<b>Dividend per share</b>	<b>38.87p</b>	38.45p

(1) Relates to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

# How we manage risk

## Principal risks and uncertainties

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

Our strategy is to create sustainable value by delivering the best service to customers, at the lowest sustainable cost and in a responsible manner. In doing this, the group is exposed to a range of internal and external risks of varying types which can impact upon us and the delivery of our objectives and operations. To understand and manage these risks, we maintain a risk management framework which includes:

- › an enterprise-wide approach to risk management;
- › a well-established governance and reporting structure (see figure 1);
- › a risk assessment and management process which is aligned to ISO 31000:2009 (see figure 2 opposite); and
- › a suite of tools, guidance material and training packages to support consistency of approach.

Business areas and functions are responsible for the identification, analysis, evaluation and management of risk relative to their business environment including new and emerging circumstances. All event types (including regulatory, legal, core operations, service and hazard) are considered for their likelihood of occurrence and both the financial and reputational impact should that event occur. Each assessment takes into account a gross position (assuming no controls or that all controls fail), a current position benefiting from an analysis of the type and effectiveness of existing controls and a targeted position where further mitigation may be required if the current position is evaluated as not meeting our objectives or obligations.

The nature and extent of the risk profile culminating from this structured approach is reported to the group board twice a year, illustrating individual event-based risks that underpin 10 inherent risk categories that are regarded as the principal risks (see pages 48 and 49). From this initial overview, the report then focuses on two categories of risk: i) the most significant group-wide business risks and ii) wholesale operational risks. These are represented by the 10 highest ranked risks (based on likelihood x 'full life' financial impact) for each of the two categories and a further five risks with potentially very high impact severity in their current state (net of control effectiveness) with reputational impact noted for awareness and management. The report also highlights risks that fall outside these categories but are included due to potential reputational impact or because they are notable new/emerging circumstances.

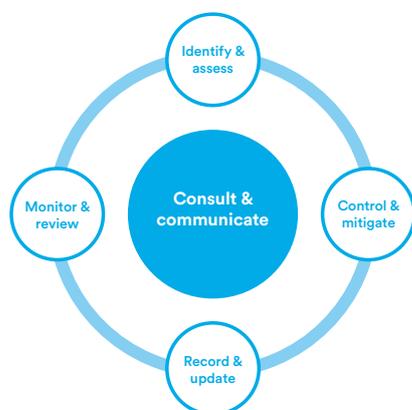
This approach is in line with the principles of the UK Corporate Governance Code and involves reporting to the group board for each full and half year statutory accounting period allowing the board to:

- › determine the nature and extent of the principal risks it is willing to take in achieving its strategic objectives;
- › oversee the management of those risks and provide challenge to executive management where appropriate;
- › express an informed opinion on the long-term viability of the company (see page 73); and
- › monitor risk management and internal control systems and review their effectiveness.



Figure 1: Governance and reporting process

**Figure 2: Assessment and management process adapted from ISO 31000:2009**



Our risk profile currently consists of around 120 event-based risks. By their nature, these will include all combinations of high to low likelihood and high to low impact. Heat maps are typically used in various managerial and group reports, either as a method to collectively evaluate the extent of multiple risks within a certain profile or to evaluate the effectiveness of mitigation for a single risk relative to the initial gross position.

## Key features and developments

Our risk profile shows that, for each set of the 10 highest ranked risks (one set for each of group-wide business risks and wholesale operational risks), the majority fall into the principal risk areas 'Political and regulatory', 'Water service' and 'Wastewater service'. Operationally, the dominance of the penalty element of the outcome delivery incentive mechanism and the effect following changes to the Environmental Sentencing Guidelines are key features of this exposure. Reputationally, our core operations/service provision (notably water service) and health, safety and environmental risks have the highest focus for monitoring and reviewing control effectiveness based on the potential impact should the risk event occur.

We aim for continuous improvement in both our governance and approach to managing risk. Changes this year include the introduction of a core risk team and additional sign-off processes relating to operational risk. We have also developed a programme focused on long-term resilience of assets, overseen by the newly formed wholesale resilience board. Associated with this is a focus on asset health and operational hazard risk assessment in advance of and beyond the 2015-20 regulatory period. This should ensure that we fully understand the long-term risk profile of our asset base and improve our capability to deliver the most cost-effective and proportionate risk management response. Other developments include: an ongoing transformation programme (with the Drinking Water Inspectorate) to address some areas of concern arising from the Lancashire incident in 2015; system optimisation in wastewater services through a remote monitoring and control transformation project; and in domestic retail, a customer service improvement plan underpinned by a clear strategy, improved complaints handling, accurate data and cultural change.

The introduction of non-household retail competition required significant preparation. Ensuring we continue to operate compliantly and in accordance with 'level playing field' requirements remains a key area of focus.

Whilst most of our operations are in the UK, the potential effects of 'Brexit' have been considered, assessed and reported to the group board. Like many companies, a key issue is the level of uncertainty that exists. Our assessment included sources of funds, costs of goods and services, our ability to collect cash in the event of an economic downturn and the

effect of any potential inflationary shift over current predictions. This area remains under review.

Looking further ahead, the expected introduction of competition in relation to certain wholesale activities and the possible introduction of competition in the provision of household retail activities at some future date all place risk on the group.

It is also important to acknowledge other potential significant change in environment and societal conditions. Climate change is expected to be one of the sector's biggest challenges, having significant and permanent implications on the water cycle and the long-term sustainability of water and wastewater services including water abstraction, supply and treatment capability, drainage, sewer capacity, wastewater treatment and discharge efficiency and effectiveness.

## Material litigation

The group robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible. Litigation of a material nature is regularly reported to the group board. Two cases of particular note are as follows, however, based on the facts currently known to us and the provisions in our statement of financial position, our directors remain of the opinion that the likelihood of these having a material adverse impact on the group's financial position is remote.

- › In February 2009, United Utilities International Limited (UUIL) was served with notice of a multiparty 'class action' in Argentina related to the issuance and payment default of a US\$230 million bond by Inversora Eléctrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The claim is for a non-quantified amount of unspecified damages and purports to be pursued on behalf of unidentified consumer bondholders in IEBA. UUIL has filed a defence to the action and will vigorously resist the proceedings given the robust defences that UUIL has been advised that it has on procedural and substantive grounds.
- › In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water Limited (Uuw) in respect of discharges of water and treated effluent into the canal. Whilst the matter has not reached a final conclusion, the Supreme Court has found substantively in Uuw's favour on a significant element of the claim and the High Court has upheld Uuw's position on the remainder of the proceedings. MSCC have now instigated further heads of claim against Uuw in order that they may continue to challenge Uuw's rights to discharge water and treated effluent into the canal.

# How we manage risk

## Principal risks and uncertainties

### Principal risks

The principal risks (aggregated clusters of event-based risks), which have been set out in the table below reflect the categories of risks that define business activity or contributing factors where value can be lost or gained and could have a material impact on the business model, future performance, solvency or liquidity of the group. In each case the magnitude of the potential effect is highlighted together with the extent of management/mitigation. To ensure relevance with the current environment, issues or areas of uncertainty are also illustrated.

	Risk description	Strategic objective	Potential impact
Regulatory and legal	<b>Political and regulatory risk</b> Potential change in the political and regulatory environment and/or frameworks	■	Changes to regulation and the regulatory regime (either through political or regulatory events, for example following Brexit) may increase costs of administration, reduce income and margin and lead to greater variability of returns.
	<b>Compliance risk</b> The potential failure to meet all legal and regulatory obligations and responsibilities	■	Reputational, brand and general damage arising from non-compliance with existing or future laws/regulations (principally relating to the regulated business, but also including non-regulated activity/commitment) can result in additional workload, financial penalties, additional capital/operating expenditure (from enforcement orders or legal defence) and compensation following litigation. In more remote but extreme circumstances, penalties of up to 10 per cent of relevant turnover and ultimately revocation of our licence or the appointment of a special administrator are possible.
Core operations and service provision	<b>Water service risk</b> Potential failure of water operational processes or assets	■	Operational performance problems or service or asset failures can lead to a failure to provide a secure supply of clean, safe drinking water or an inability to remove, treat and return water to the environment. This can cause public health, community and environmental impacts, additional operating or capital expenditure and/or increased regulatory scrutiny and regulatory penalties. In more extreme situations the group could also be fined for breaches of statutory obligations, be subject to enforcement action, be held liable to third parties and sustain reputational damage.
	<b>Wastewater service risk</b> Potential failure of wastewater operational processes or assets	■	
	<b>Retail and commercial risk</b> Potential inability to provide good and fair service to domestic customers and third party retailers	■	Poor service to customers can result in financial penalties and an impact on regulatory reputation. The opening of the market for retail services to all non-household customers in England in April 2017 has generated both opportunities and risk for the group and its associated business retail function in respect of income, margin and debt. Breaches of legal and regulatory requirements could lead to fines, penalties and reputational damage. Uncertainty remains in respect of potential upstream reform from 2020.
Functional service and support	<b>Financial risk</b> Potential inability to appropriately finance the business	■	The failure of financial counterparties could result in additional financing cost, an adverse impact on the income statement and potential reputational damage. Variability in inflation (as measured by the UK Retail Prices Index) and changes in interest rates, funding costs and other market risks could adversely impact the economic return on the Regulatory Capital Value. Increased pension scheme deficit could lead to a requirement for the group to make additional contributions. In extreme but remote cases adverse market conditions could affect our access to debt capital markets and subsequently available liquidity and credit ratings.
	<b>Programme delivery risk</b> Potential ineffective delivery of capital, operational and change programmes/processes	■	Failure to deliver capital or change programmes against relevant time, cost or quality measures could result in a failure to secure competitive advantage or operating performance efficiency and cost benefits. There is also the risk of increased delivery costs or a failure to meet our obligations and customer outcomes which, depending on the nature and extent of failure, could result in an impact at future price reviews, failure of legal or regulatory obligations and subsequent penalties. This could lead to negative reputational impact with customers and regulators.
	<b>Resource risk</b> The potential inability to provide appropriate resource (human, system, technological or physical) required to support business activity	■	The capacity or capability associated with human, technological and physical resource (including information, operational technology, skill sets, systems and telecommunications) can lead to poor efficiency and effectiveness of business activity, the inability to make appropriate decisions and ultimately meet targets. This can also affect the ability to recruit and retain knowledge/expertise or to recover effectively following an incident. In remote but extreme circumstances there is also the potential for higher levels of regulatory scrutiny, financial penalties, reputational damage and missed commercial opportunities.
Hazard-based	<b>Security risk</b> The potential inability to protect people, information, infrastructure and non-infrastructure from malicious or accidental activity	■	Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) which could impact the provision of vital services and/or harm people or commercial businesses. In addition, commercial or sensitive information could be lost.
	<b>Health, safety and environmental</b> Potential for operational or natural hazards to affect employees, contractors, the public or the environment	■	Working with and around water, sewage, construction and excavation sites, plant and equipment exposes people and the environment to man-made and naturally occurring hazards. This could result in harm to people, wildlife and natural habitats and lead to increased work down time and additional operational costs, for example environmental clean-up. Depending on the circumstances, the group could be fined heavily for breaches of statutory obligations, be held liable to compensate third parties and sustain severe reputational damage.

### Strategic objectives

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

### Risk exposure

An indication of each category's current exposure relative to the previous year is shown by the arrow in the risk exposure column.



Current key risks, issues or areas of uncertainty include	Risk exposure	Management and mitigation
<ul style="list-style-type: none"> <li>– Market reform including non-household and upstream competition and, further ahead, the potential for the introduction of household competition</li> <li>– A possible change from using the Retail Prices Index to the Consumer Prices Index for regulatory indexation</li> <li>– Brexit</li> </ul>	↑	<p>We engage in relevant government and regulatory consultations which may affect policy and regulation in the sectors where we operate. We also consult with customers to understand their requirements and proactively consider all the opportunities and threats associated with any potential change, exploiting opportunities and mitigating risks where appropriate.</p>
<ul style="list-style-type: none"> <li>– Competition law and regulatory compliance whilst preparing for and operating within a changing competitive market</li> <li>– Level playing field requirements in relation to non-household retail</li> <li>– Current material litigation</li> <li>– New higher fine levels for environmental offences</li> </ul>	→	<p>Legislative and regulatory developments are continually monitored. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any material additional compliance costs in the regulated business is sought as part of the price determination process. The group also robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible.</p>
<ul style="list-style-type: none"> <li>– Water quality</li> <li>– Interruption to supply</li> <li>– Structural integrity of major assets</li> <li>– Pollution</li> <li>– Population growth</li> <li>– Climate change</li> <li>– Meeting infrastructure investment requirements</li> <li>– Expected change to the abstraction licensing regime</li> </ul>	→  ↑	<p>Mitigation is provided through core business processes, including forecasting, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Ongoing system and network integration improves service provision and measures of success have been developed to monitor performance. Following the Lancashire water quality incident in 2015 we are further enhancing our approach to operational risk and resilience.</p>
<ul style="list-style-type: none"> <li>– Socio-economic deprivation in the North West</li> <li>– Welfare reform and the impact on domestic bad debt</li> <li>– Competition in the water and wastewater market and competitor positioning</li> <li>– Market reform and the ability to treat other participants equally</li> </ul>	→	<p>For domestic retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Similarly, within business retail we looked to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitored competitor activity and targeted a reduction in operating costs. Within our wholesale department processes, systems, data and organisational capacity and capability to deal with market participants and the central market operator have been delivered. The new market requirements will require all market participants to treat other participants equally (on a 'level playing field') whilst maintaining compliance with existing regulations.</p>
<ul style="list-style-type: none"> <li>– Stability of financial institutions and the world economy</li> <li>– Economic uncertainty</li> <li>– Inflation/deflation</li> <li>– Financial market conditions, interest rates and funding costs</li> </ul>	→	<p>Refinancing is long-term with staggered maturity dates to minimise the effect of short-term downturns. Counterparty credit, exposure and settlement limits exist to reduce any potential future impacts. These are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. The group also employs hedging strategies to stabilise market fluctuation for inflation, interest rates and commodities (notably energy prices). Sensitivity analysis is carried out as part of the business planning process, influencing the various financial limits employed. Continuous monitoring of the markets takes place including movements in credit default swap prices and movements in equity levels.</p>
<ul style="list-style-type: none"> <li>– Security of supply</li> <li>– Delivery of solutions</li> <li>– Quality and innovation</li> <li>– New contract delivery partnerships for the 2015-2020 period with a new approach to construction and design</li> </ul>	↓	<p>We have a developed and clear view of our investment priorities which are built into our programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service provider including alignment with our operating model. Our programme and project management capabilities are well established with strong governance and embedded processes to support delivery, manage risks and achieve business benefits. We utilise a Time, Cost and Quality index (TCQI) as a key performance indicator and enhance our performance through a dedicated programme change office to deliver change in a structured and consistent way. Supply chain management is utilised to deliver end-to-end contract management which includes contract strategy and tendering, category management, security of supply, price and price volatility and financial and operational service level performance.</p>
<ul style="list-style-type: none"> <li>– Delivering required employee engagement</li> <li>– Personal development and talent management</li> <li>– Technological innovation</li> <li>– Asset management</li> </ul>	→	<p>Developing our people with the right skills and knowledge, combined with delivering effective technology, are important enablers to support the business to meet its objectives. Employees are kept informed regarding business strategy and progress through various communication channels. Training and personal development programmes exist for all employees in addition to talent management programmes and apprentice and graduate schemes. We focus on change programmes and innovative ways of working to deliver better, faster and more cost-effective operations.</p>
<ul style="list-style-type: none"> <li>– Ownership and operation of National Infrastructure and Critical National Infrastructure</li> <li>– Cybercrime</li> <li>– Terrorism</li> </ul>	→	<p>Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Recent initiatives include awareness training across the business relating to seven key areas of security and the implementation of a security governance model to oversee all aspects of security and security strategy. Ongoing system and network integration improves operational resilience and we maintain robust incident response, business continuity and disaster recovery procedures. We also maintain insurance cover for loss and liability and the licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers in the event of a catastrophic incident.</p>
<ul style="list-style-type: none"> <li>– Extreme weather conditions</li> <li>– Excavation, tunnelling and construction work</li> <li>– Working with substances hazardous to human health</li> <li>– Working with water and wastewater</li> <li>– Driving and vehicle movement</li> </ul>	→	<p>We have developed a strong health, safety and environmental culture where 'nothing we do at United Utilities is worth getting hurt for'. This is supported by strong governance and management systems which include policies and procedures which are certified to OHSAS 18001 and ISO 14001.</p>



**Ensuring the  
long-term success  
of the company  
and the group**



# Governance

The corporate governance report presents information on the board of United Utilities and its activities and those of the various committees and sets out how the board demonstrates leadership, effectiveness and its accountability to the company's stakeholders and its approach to the remuneration of the directors.

Corporate governance report	
Board of directors	52
Letter from the Chairman	56
Nomination committee report	66
Audit committee report	74
Corporate responsibility committee report	82
Remuneration committee report	86
Tax policies and objectives	110
Directors' report	111
Statement of directors' responsibilities	117

# Corporate governance report

## Board of directors



**Dr John McAdam**  
Chairman

**Responsibilities:** Responsible for the leadership of the board, setting its agenda and ensuring its effectiveness on all aspects of its role.

**Qualifications:** BSc (Hons) Chemical Physics, Diploma Advanced Studies in Science, PhD.

**Appointment to the board:** Appointed as a non-executive director in February 2008 and as Chairman in July 2008.

**Committee membership:** Nomination (chair).

**Skills and experience:** With over 18 years' service as a board director in a wide range of companies, and as a current non-executive director serving on a number of other boards and across different sectors, John has a wealth of past and current experience on which to draw in his role as Chairman and leader of the board.

**Career experience:** Appointed to the board of ICI plc in 1999 and became chief executive in 2003, a position held until ICI's takeover by Akzo Nobel. He stepped down from the role of senior independent director at J Sainsbury plc in July 2016 and as a non-executive director of Rolls-Royce Holdings plc in May 2017.

**Current directorships/business interests:** Chairman of Rentokil Initial plc and senior independent director of Electra Private Equity PLC. He is also Chairman of United Utilities Water Limited.

**Independence:** John met the Code's independence criteria at the time of his initial appointment as Chairman.



**Steve Mogford**  
Chief Executive Officer (CEO)

**Responsibilities:** To manage the group's business and to implement the strategy and policies approved by the board.

**Qualifications:** BSc (Hons) Astrophysics/Maths/Physics.

**Appointment to the board:** January 2011.

**Committee membership:** Corporate responsibility.

**Skills and experience:** Steve's experience of the highly competitive defence market and complex design, manufacturing and support programmes has driven forwards the board's strategy of improving customer service and operational performance at United Utilities, and his perspective of the construction and infrastructure sector provides valuable experience and insight to support United Utilities' capital investment programme.

**Career experience:** Previously chief executive of SELEX Galileo, the defence electronics company owned by Italian aerospace and defence organisation Finmeccanica, and chief operating officer at BAE Systems PLC and a member of its PLC board, he spent his earlier career with British Aerospace PLC. He stepped down from the board at Carillion PLC in December 2015 where he had served as the senior independent director until September 2015.

**Current directorships/business interests:** Appointed as senior independent director of G4S PLC in May 2016. He is also chief executive officer of United Utilities Water Limited.



**Russ Houlden**  
Chief Financial Officer (CFO)

**Responsibilities:** To manage the group's financial affairs and to contribute to the management of the group's business and to the implementation of the strategy and policies approved by the board.

**Qualifications:** BSc (Hons) Management Sciences, Fellow of the Chartered Institute of Management Accountants, Chartered Global Management Accountant and a Fellow of the Association of Corporate Treasurers.

**Appointment to the board:** October 2010.

**Committee membership:** Treasury.

**Skills and experience:** Russ's skills and experience in accounting, treasury, tax, M&A and investor relations in other commercial and regulated companies, along with his extensive experience of driving performance improvement and managing large capital investment programmes, provides the group with valuable expertise in pursuing its strategy to drive for improvements in customer service and in providing our services at the lowest sustainable cost.

**Career experience:** Chief financial officer at Telecom New Zealand. Previously finance director of Lovells, BT Wholesale, BT Networks and Information Services, ICI Polyurethanes and ICI Japan.

**Current directorships/business interests:** Member of the supervisory board and chairman of the audit committee of Orange Polska SA, the largest listed telecommunications company in Poland. He is a member of the main committee and chairman of the financial reporting committee of the 100 Group. He is also chief financial officer of United Utilities Water Limited.



### Mark Clare

Senior independent non-executive director

**Responsibilities:** Is responsible, in addition to his role as an independent non-executive director, for discussing any concerns with shareholders that cannot be resolved through the normal channels of communication with the Chairman or Chief Executive Officer.

**Qualifications:** Chartered Management Accountant (FCMA).

**Appointment to the board:** November 2013.

**Committee membership:** Nomination and remuneration.

**Skills and experience:** In his roles at British Gas and BAA Mark has a strong background operating within regulated environments. His extensive knowledge of customer-facing businesses is particularly valuable for United Utilities with the implementation of greater competition in the industry and in pursuit of its strategy to improve customer service.

**Career experience:** Mark retired from his position as chief executive at Barratt Developments plc in July 2015, a role he had held for nine years. He is a former trustee of the Building Research Establishment and the UK Green Building Council. Prior to joining Barratt, he was an executive director of Centrica plc and held a number of senior roles within both Centrica plc and British Gas. Mark was also a non-executive director of BAA plc, the airports operator.

**Current directorships/business interests:** He was appointed non-executive chairman of Grainger plc in February 2017 and as the senior independent director of Ladbrokes Coral PLC in September 2016. He is also a non-executive director of Premier Marinas Holdings Limited. He is also an independent non-executive director of United Utilities Water Limited.



### Stephen Carter

Independent non-executive director

**Responsibilities:** To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the board's agenda on acting responsibly as a business.

**Qualifications:** Bachelor of Law.

**Appointment to the board:** September 2014.

**Committee membership:** Nomination, audit and corporate responsibility (chair).

**Skills and experience:** As the chief executive officer of a FTSE listed company, Stephen brings current operational experience to the board. His public sector experience provides additional insights to the board regarding regulation and government relations, and his experience in the media and technology industries provides additional perspective for the board's discussions.

**Career experience:** Group chief executive at Informa plc, having previously served on the board of the Informa Group as a non-executive director and member of the audit committee. Previous executive roles include president/managing director, Europe, Middle East and Africa, and a member of the executive management board at Alcatel Lucent Inc. Stephen has also held a number of public service roles, serving a term as the founding chief executive of Ofcom. He was formerly chairman of the board at Ashridge Business School. He is a Life Peer.

**Current directorships/business interests:** Group chief executive at Informa plc and a non-executive director of the Department for Business, Energy and Industrial Strategy. He is also an independent non-executive director of United Utilities Water Limited.



### Alison Goligher

Independent non-executive director

**Responsibilities:** To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board.

**Qualifications:** BSc (Hons) Mathematical Physics, MEng Petroleum Engineering.

**Appointment to the board:** August 2016.

**Committee membership:** Nomination, audit (relinquished with effect from 1 July 2017), remuneration and corporate responsibility.

**Skills and experience:** Alison has strong technical and capital project management skills, having been involved in large projects and the production side of Royal Dutch Shell's business. This experience of engineering and industrial sectors provides the board with additional insight into delivering United Utilities' capital investment programme.

**Career experience:** From 2006 to 2015, Alison worked for Royal Dutch Shell, with her most recent executive role as Executive Vice President Upstream International Unconventionals. Prior to that she spent 17 years with Schlumberger, an international supplier of technology, integrated project management and information solutions to the oil and gas industry.

**Current directorships/business interests:** She is a non-executive director of Meggitt PLC and was appointed as part-time executive chair of Silixa Ltd in August 2016. She is also an independent non-executive director of United Utilities Water Limited.

# Corporate governance report

## Board of directors



**Brian May**  
Independent non-executive director

**Responsibilities:** To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the audit committee.

**Qualifications:** BSc (Hons) Actuarial Science, Chartered Accountant FCA.

**Appointment to the board:** September 2012.

**Committee membership:** Nomination, audit (chair), treasury (chair) and remuneration (with effect from May 2017).

**Skills and experience:** Brian joined Bunzl plc in 1993 as head of internal audit before becoming group treasurer, then finance director (Europe and Australasia), and is currently finance director. Brian's background and the various finance roles that he has held are major assets to the board in chairing both the audit and the treasury committees.

**Career experience:** Brian has been finance director at Bunzl plc since 2006 and prior to that held a number of senior finance roles within the company. Prior to joining Bunzl, Brian qualified as a chartered accountant with KPMG.

**Current directorships/business interests:** Finance director at Bunzl plc. He is also an independent non-executive director of United Utilities Water Limited.



**Paulette Rowe**  
Independent non-executive director

**Responsibilities:** To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board.

**Qualifications:** MSc Mechanical Engineering and Management, MBA.

**Appointment to the board:** 1 July 2017.

**Committee membership:** Nomination and audit.

**Skills and experience:** Paulette has spent most of her career in the regulated finance industry which will provide the board with additional perspective and first hand regulatory experience. Her experience of technology driven transformation will contribute to United Utilities' customer experience programme and Systems Thinking approach.

**Career experience:** Paulette is managing director, Global Payments Acceptance at Barclaycard. Prior to joining Barclays, she was strategy director at NBNK Investments plc and before which she was commercial and marketing director at Tesco Personal Finance. She spent seven years at the Royal Bank of Scotland, where her roles included chief executive European Consumer Finance and managing director, NatWest Retail Banking. She has served on the board of the Prince's Youth Business Trust and as a trustee for Community Service Volunteers.

**Current directorships/business interests:** She is non-executive chair of the Mayor's Fund for London. She is also an independent non-executive director of United Utilities Water Limited.



**Sara Weller**  
Independent non-executive director

**Responsibilities:** To challenge constructively the executive directors and monitor the delivery of the strategy within the risk and control framework set by the board and to lead the board's activities concerning directors' remuneration.

**Qualifications:** MA Chemistry.

**Appointment to the board:** March 2012.

**Committee membership:** Nomination and remuneration (chair).

**Skills and experience:** Sara's experience of customer-facing businesses, together with her knowledge of operating within a regulated environment, provides the board with valuable perspective as the company responds to the increased competition in the sector and improves its service to customers.

**Career experience:** Sara has wide-ranging business experience, having worked for Mars, Abbey National and J Sainsbury plc and latterly as managing director of Argos from 2004 to 2011. She served as the senior independent director at Mitchells and Butlers plc from 2003 to 2006 and also chaired its remuneration committee from 2003 to 2010. She was the former lead non-executive director for the Department for Communities and Local Government.

**Current directorships/business interests:** Non-executive director of Lloyds Banking Group plc. Sara is chair of the Planning Inspectorate (an executive agency of the Department of Communities and Local Government), lead non-executive director for the Department of Work and Pensions, a board member at the Higher Education Funding Council for England and a council member at Cambridge University. She is also an independent non-executive director of United Utilities Water Limited.

### Notes:

Dr Catherine Bell stepped down from the board on 22 July 2016.

All our directors are seeking reappointment/election at the 2017 AGM. Details of the percentage of votes cast in favour of their appointment at the 2016 AGM are given on page 71.



Pictured: Board visit to Liverpool wastewater treatment works

# Corporate governance report

## Letter from the Chairman

Our core values of acting with integrity and focusing on our customers provides the framework for both our business culture and the way in which our employees go about their daily work. 'Acting responsibly' has been part of the United Utilities ethos for a number of years.

### Quick facts



- The Chairman met the independence criteria as set out in the 2014 UK Corporate Code (the Code) when he was appointed as Chairman
- The Code requires that at least half of the board is made up of independent non-executive directors (the test excludes the Chairman). At United Utilities, six out of the remaining eight directors (excluding the Chairman) are independent non-executive directors
- The company secretary attends all board and committee meetings and advises the Chairman on governance matters. The company secretariat team provides administrative support
- All directors are subject to annual election at the Annual general meeting (AGM) held in July. Following the completion of the annual evaluation process all the non-executive directors were considered by the board to be independent and making a valuable and effective contribution to the board. As a result, the board recommends that shareholders vote in favour of those standing for a further term at the forthcoming AGM, as they will be doing in respect of their individual shareholdings

### Quick links

The details of the matters that the board has reserved for its own decision are set out in the 'Schedule of matters reserved for the board'. A copy can be found at: [corporate.unitedutilities.com/corporate-governance](http://corporate.unitedutilities.com/corporate-governance)

A copy of the FRC 2014 UK Corporate Governance Code can be found at: [frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf](http://frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf)

### Dear Shareholder

#### Our year

We have seen strong performance contributing towards achieving our strategic targets during 2016/17 as demonstrated by progress in meeting our customer, environmental and financial targets. The annual investment of around £800 million in building water and wastewater assets has been completed according to our plan.

#### Our approach

As individual directors we are cognisant of our statutory duties. Our role as the board is to set the strategy of the group and ensure that management operates the business in accordance with the strategy in order to safeguard both its long-term success and our customers' interests and to create shareholder value. As a board we have a strong sense of common purpose: our intention is to hand over the business to our successors in a better and more sustainable position for the future. Information on our vision and strategy and the way in which we create value is included in the strategic report on pages 10 to 49.

#### Our governance structure

We held eight scheduled board meetings during the year; in addition there were a number of other board meetings held which directors attended either in person or via telephone conferencing facilities. A diagram showing the inter-relationships of the various board committees can be found on page 59, and reports from each of the committee chairs about their work can be found on the following pages. The diagram also describes some of the group's principal management committees.

#### Our people

You may recall that we reported in our 2016 annual report that Catherine Bell, after nine years' service, was stepping down at the annual general meeting in July 2016, and that Alison Goligher would join the board as an independent non-executive director with effect from 1 August 2016. We recently announced that Paulette Rowe would be appointed as an independent non-executive director joining the board on 1 July 2017. More information about Paulette's appointment can be found in the nomination committee report on page 68.

We have maintained our target of at least 25 per cent of our board comprising women. In terms of diversity of experience, skills and personal attributes, I believe we have great diversity around our board. The directors have many years of experience gained across a variety of industries and regulated businesses. Good board dynamics are vital to the proper interaction and working of a board of directors. Board directors need to work together effectively for the good of the company and, in short, they need to get on with each other; clashes of personality are to be avoided as they do not facilitate constructive debate and challenge or effective communication. I believe we have individuals who will apply their skills and experience to the benefit of our business and speak up if they disagree but, equally, listen to the views of others. Looking ahead, the board considered the forthcoming 2016 Code requirement, that the 'audit committee as a whole shall have competence relevant to the sector



**Pictured:** Dr John McAdam, Chairman

in which the company operates' and concluded that when taking into account the skills, knowledge, experience and professional qualifications of committee members (see the directors' biographies on pages 52 to 54) this 2016 Code requirement was fulfilled. Furthermore, all members of the audit committee are independent non-executive directors.

Although there are time constraints for non-executive directors who also have an executive role, these individuals bring valuable current market experience to our board table. Similarly, we encourage our executive directors to serve as non-executive directors elsewhere to help broaden their experience, although this is normally limited to one other directorship in a company which does not conflict with United Utilities' business.

At the time this report was approved, 38 per cent of our executive team is made up of women. We are keen to develop our female senior managers so that, over time, they can be considered for executive board appointments or as potential candidates for non-executive directorships in other companies. Our current talent programme at a senior level is well embedded and we believe a non-executive appointment provides an excellent opportunity for both personal and career development and it is a way of gaining valuable experience that may be applied at United Utilities so long as no conflicts of interest occur. Our graduate and apprentice programmes are thriving and we are focusing more effectively on middle/junior management succession.

### Our values and culture

Our aim is to act as a responsible business, and our business principles can be found on our website (see page 65). Our core values of acting with integrity and focusing on our customers provides both the framework for our business culture and the way in which our employees go about their daily work. 'Acting responsibly' has been part of the United Utilities ethos for a number of years. One of the key responsibilities of the board is to appoint the CEO. Steve Mogford is a passionate supporter of the company's agenda to act as a responsible business.

In accordance with our aim of acting as a responsible business, the company has complied fully with the main and subsidiary principles and provisions of the 2014 UK Corporate Governance Code, with which we are required to comply by the FCA's Listing Rules for the year ended 31 March 2017.

### Our approach to risk

Our approach toward risk is very much aligned with our culture. We are an organisation that provides a vital service to its customers and we recognise the responsibilities of this, and our intention is to act responsibly towards our stakeholders, in particular our customers, in the provision of our services to them. As a board, on behalf of our business we must take long-term decisions in order that our successors are able to operate the business efficiently for customers in the future and we need to build our assets to meet future demand and circumstances. We are a commercial organisation operating within a regulated framework and accepting some level of risk is a normal consequence of doing business. It is the board and the executive team's role to understand the risks associated with each activity of the business and ensure that actions are taken to mitigate these risks.

### Our investors

We are in regular contact with our large investors through a regular scheduled programme of meetings attended by either our CEO or CFO or both of them. The programme is also supported by the activities of our investor relations team who are readily available to address investors' queries. Mark Clare, senior independent director and myself are also available, and the company secretary and I had the opportunity to meet with several investors during the year.

Ensuring that the directors' remuneration packages align the directors' and senior managers' interests with the long-term interests of the company and its shareholders is always a key area of interest for investors. The directors' remuneration policy, last approved by shareholders at the 2014 AGM, is again on the 2017 annual general meeting agenda. This reflects the Companies Act 2006 requirement that a company's remuneration policy must be approved by shareholders every three years. The new directors' remuneration policy can be found on pages 91 to 97 and is intended to apply until the 2020 AGM. The remuneration committee under Sara Weller's leadership has again engaged with a number of the company's large investors to ensure that we are aligned with their views. Although only advisory, at the AGM in 2014, and the subsequent two AGMs, over 99 per cent of the votes were cast in favour of the directors' remuneration report.

We welcome any feedback you may have on this annual report – please email any comments you may have to [secretariat@uuplc.co.uk](mailto:secretariat@uuplc.co.uk)

**Dr John McAdam**  
Chairman

# Corporate governance report

## Code principles

### Leadership

Read more about [Leadership](#) on page 58

### Effectiveness

Read more about [Effectiveness](#) on page 62

### Relations with shareholders

Read more about [Relations with shareholders](#) on page 71

### Accountability

Read more about [Accountability](#) on page 72

### Remuneration

Read more about [Remuneration](#) on page 73

## Code principle – Leadership

### Introduction by Dr John McAdam

**“There is renewed focus on how boards discharge their duties, having regard to the long-term success of the company for its members and wider stakeholders. I hope, when you have read our strategic report (on pages 10 to 49) and this corporate governance report, you will be left with an understanding of how we operate our business on a day-to-day basis, whilst looking to the future to ensure we continually focus on our strategy of delivering the best service to customers, at the lowest sustainable cost while acting in a responsible manner.”**

### Overview of the board’s responsibilities

- › Sets the strategy of the group, ensuring the long-term success of the group for customers, investors and wider stakeholders and in creating shareholder value
- › Is responsible for challenging and encouraging the executive team in its interpretation and implementation of how it manages the business, and that it is doing so in accordance with the strategic goals the board has set
- › Has responsibility for ensuring the company’s internal control systems (including financial, operational and compliance) and processes are sound and fit for purpose. See the ‘accountability’ section of this report on page 72 for more detail

- › Must ensure that the company has the necessary financial resources and people with the necessary skills to achieve its objectives. It also reviews managerial performance annually
- › Has oversight of capital expenditure projects within U UW which exceed £50 million, and any project which materially increases the group’s risk profile or is not in the ordinary course of the group’s business

Full details of the matters that the board has reserved for its own decision-making, due to their importance to the business or the working of the board, can be found on our website at:

[corporate.unitedutilities.com/corporate-governance](http://corporate.unitedutilities.com/corporate-governance)

### Governance structure for our board and our committees

In line with the Code, the board delegates certain roles and responsibilities to its principal board committees, as shown in the diagram opposite. Whilst the board retains overall responsibility, a sub-committee structure allows these committees to probe the subject matter more deeply and gain a greater understanding of the detail, and then report back to the board on the matters discussed, decisions taken, and where appropriate, make recommendations to the board on matters requiring its approval. The reports of the principal board committees required by the Code can be found on the subsequent pages. Minutes of the board and principal committee meetings (with the exception of the remuneration committee) are tabled at board meetings and the chairs of each of the board committees report verbally to the board on their activities. The Chairman chairs the nomination committee; all other principal board committees are chaired by independent non-executive directors who have particular skills or interests in the activities of those committees.

The executive team is chaired by the Chief Executive Officer (CEO), and its members are the senior managers who have a direct reporting line to the CEO. The executive team meets monthly; it is responsible for operational matters and implementing the strategies that the board has set, and the day-to-day running of the business. Short biographies of the executive team can be found on our website at: [corporate.unitedutilities.com/united-utilities-executive-team](http://corporate.unitedutilities.com/united-utilities-executive-team)

The structure chart shown opposite also shows the principal management committees and a brief description of their roles. These committees enable senior management to understand and, if necessary, challenge the business in its interpretation of the implementation of the strategies the board has set. The board received reports from the CEO and Chief Financial Officer (CFO) at every scheduled board meeting, providing the board with an updated overview of the business and its financial performance and position.

**Governance structure of the board and its principal committees and the principal management committees.**



**Key:**

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

# Corporate governance report

## Summary of board activity in 2016/17

	Cross reference	Link to strategic objectives
<b>Leadership and employees</b>		
— Regular review of health and safety incidents of employees and contractors reflecting the company's belief that 'nothing we do is worth getting hurt for'	See page 38	
— Considered board succession planning and the appointment of a new non-executive director	See page 68	
— Reviewed and discussed executive succession plans and the needs of the business; the potential changes arising out of market reform; and received an update on the activities to develop talented employees in the senior leadership team but also extending this focus to middle management and further increasing diversity, given the strong progress already made in the apprentice and graduate programmes	See page 66	
— Discussed the results of the annual employee engagement survey	See page 38	 
<b>Strategy</b>		
— Reviewed the group's corporate responsibility activities focusing on reputation management, particularly in our communication with stakeholders	See page 84	
— Received regular updates at each meeting of items with strategic component, such as emerging changes to regulation, major capital expenditure and business structuring decisions		  
— Held the annual full day strategy session debating and discussing the context of the next price review, the key issues to be addressed and considered the expectations of our key stakeholders	See page 5	  
<b>Governance</b>		
— Reviewed and debated the risk profile of the group and in particular the principal risks which included greater visibility of operational risks following a change in the underlying risk assessment process	See page 46	  
— Reviewed the effectiveness of the risk management systems, including financial, operational and compliance controls and reviewed the effectiveness of the internal control systems	See page 72	  
— Reviewed and discussed developments in cybercrime and the activities undertaken to enhance the effectiveness of the group's security controls and work with various government agencies and a number of other water companies to define cyber security guiding principles for use across the industry	See page 23	 
— Reviewed the terms of reference for the audit, remuneration, treasury and corporate responsibility committees and received post-meeting reports from the chairs of each committee summarising discussions and actions		
— Reviewed biannual updates on changes and developments in corporate governance and the implementation of any changes required	See page 64	
— Reviewed and discussed the annual evaluation of the board, its committees and individual directors and conflicts of interest	See page 63	
— Reviewed the performance of the external auditor and recommendation for reappointment	See page 76	 
— Reviewed the approach, background work and progress of work to identify areas where there is any risk of modern slavery occurring in our supply chain contributing to the development of and approval of the slavery and human trafficking statement	See page 115	

### Key:

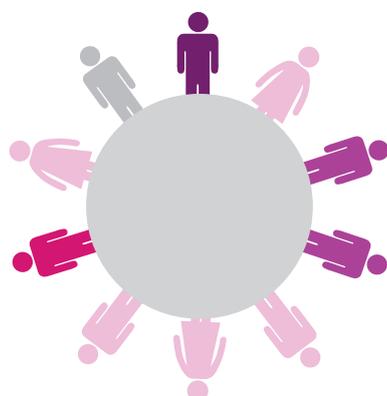
 The best service to customers  At the lowest sustainable cost  In a responsible manner

## Summary of board activity in 2016/17

	Cross reference	Link to strategic objectives
<b>United Utilities Water Limited (UW) regulated business</b>		
— Reviewed the progress with the implementation of the recommendations of the internal investigation undertaken by Mark Clare, senior independent director, in relation to the August 2015 Lancashire water quality incident and lessons learnt	See page 72	
— Regular updates on the progress of our preparations (supported by independent assurance, particularly in relation to systems readiness), on the transfer of the commercial customer base to Water Plus (the group's joint venture with Severn Trent) prior to the opening of the market for commercial customers on 1 April 2017 along with monitoring the changes to our own systems and processes supporting our role as a wholesaler of water and wastewater services	See page 4	
— Monitored progress of the implementation of the customer experience programme to improve customer service including new initiatives such as 'Priority Services' and 'Moving Home', improved training for employees handling customer calls and systems improvements	See page 35	
— Received regular updates on developments by Ofwat's view of the next five-year asset management period (known as 'Water 2020') and its approach to the Price Review in 2019	See page 5	
<b>Other group business</b>		
— Reviewed progress on the group's renewable energy generation capabilities and opportunities for expansion and innovation including developing our plans around battery storage of power for use overnight when solar panels are not generating	See page 23	
— Regular updates on the progress of the joint venture Water Plus' preparedness prior to the opening of the market for commercial customers on 1 April 2017	See page 4	
<b>Shareholder relations</b>		
— Received and discussed a presentation by Makinson Cowell (in May 2016) on investors' views and perceptions (after a tender process Rothschild Investor Advisory were appointed as investor relations advisers with effect from 1 April 2017)	See page 71	
— Received and discussed feedback from roadshows/presentations to investors by the CEO and/or the CFO and communications from large investors	See page 71	
<b>Financial</b>		
— Reviewed the 2016-20 business plan and approved the 2017/18 budget		
— Reviewed and approved the half and full year results and associated announcements		
— Reviewed and approved the company's tax strategy	See page 110	
— Reviewed and approved the company's treasury policy, the group's funding requirements for the year and the potential sources to meeting these funding requirements (including the first issue of consumer price index-linked debt) and managing the group's interest rate and other market risk exposures including the impact of Brexit	See page 42	
— Reviewed progress with material litigation involving the group	See page 47	
— Reviewed and discussed pensions and proposals in relation to the United Utilities defined benefit pension scheme and related discussions with the trade unions		

# Corporate governance report

## The boardroom table



- Chairman
- Executive director
- Senior independent non-executive director
- Independent non-executive director
- Company secretary

## Attendance at board and committee meetings

Eight scheduled board meetings were planned and held during the year (2016: eight). A number of other board meetings and telephone conferences were also held during the year, as the need arose.

The table below shows the actual number of scheduled meetings attended and the maximum number of scheduled meetings which the directors could have attended. Only in exceptional circumstances would directors not attend board and committee meetings. Similarly, every effort is made to attend ad hoc meetings either in person or via the use of video or telephone conferencing facilities if needs be. None of our non-executive directors have raised concerns over the time commitment required of them to fulfil their duties.

On the evening before most scheduled board meetings all the non-executive directors meet together with the CEO; this time is usefully spent enabling board colleagues to share views and consider issues impacting the company. Time together also helps to build relationships on a personal level, which contributes to better relationships and decision-making around the board table.

	Board meetings	Audit committee	Remuneration committee	Nomination committee	Corporate responsibility committee	Treasury committee
Dr John McAdam	8/8	–	–	4/4	–	–
Steve Mogford	8/8	–	–	–	2/2	–
Russ Houlden	8/8	–	–	–	–	4/4
Dr Catherine Bell <sup>(1)</sup>	4/4	1/1	3/3	2/2	–	–
Stephen Carter	8/8	4/4	–	3 <sup>(2)</sup> /4	2/2	–
Mark Clare	8/8	–	6/6	4/4	–	–
Alison Goligher	4/4	3/3	3/3	2/2	2/2	–
Brian May	8/8	4/4	–	4/4	–	4/4
Sara Weller	8/8	–	6/6	4/4	–	–

Actual number of meetings attended/maximum number of scheduled meetings which the directors could have attended during 2016/17.

Excludes Paulette Rowe who was not appointed until 1 July 2017.

(1) Dr Catherine Bell stepped down from the board on 22 July 2016.

(2) Stephen Carter was unable to attend a meeting of the nomination committee due to a conflicting commitment.

## Code principle – Effectiveness

### Introduction by Dr John McAdam

**“Board colleagues have approached the evaluation process with resolve this year, underpinned by the forthcoming challenges of competition and the lessons learnt from the 2015 Lancashire water quality incident.”**

### Board evaluation

Our board evaluation was again conducted internally this year; our last external evaluation was conducted by Lintstock consultants in 2015.

The internal evaluation process was facilitated by the company secretary and his team. It was based on the completion of questionnaires (including questions to be scored and free text questions) by board members assessing both the performance of

the board and of each of its principal committees, and that of the Chairman and each of the individual non-executive directors. Board members were also asked to provide a view on how well the actions identified in the 2015/16 evaluation had been addressed.

In addition to board members, other members of the executive team who regularly attend and support the various committee meetings were asked to complete the same questionnaires where applicable.

The results, once reviewed by the company secretary, were then discussed with the Chairman and the chair of the relevant committee; tabled at a meeting of the relevant committee; and then presented to the board. The Chairman reviewed the performance of the individual directors. Mark Clare, as the senior independent director, in discussion with the other non-executive directors, led the review of the Chairman’s performance.

A summary of the analysis of the 2016/17 evaluation is as follows:

2016/17 areas of assessment	Commentary and actions
<b>Board composition and expertise</b>	Board members' skills and expertise were felt to be appropriate and the board was felt to be balanced in terms of composition. Board meetings were conducted in an atmosphere where open communication was encouraged to facilitate the proper resolution of issues.
<b>Board agenda</b>	The board was well informed about the regulatory environment the company operates within and had a good understanding of the views of investors, but would benefit from more opportunities to gain a better understanding of the views of customers and on service delivery and technical innovations for customers.
<b>Board support</b>	The timeliness of the distribution of board documentation was appropriate. A number of suggestions were made to the content, format and length of papers, and board time was being better used in discussion of the issues rather than merely receiving presentations. The support and training needs of board members continued to be addressed and there was considerable support amongst board members for directors individually to pursue opportunities to get a closer view of aspects of the business of particular interest to them.
<b>Wider strategic oversight</b>	The involvement of the board in the development of the strategic direction of the group was considered to be appropriate and the format and content of the board strategy away day held during the year was felt to have improved, but more time should be allowed for key strategic topics.
<b>Risk management and internal control</b>	The board's approach to the management of risk and to its systems of internal control were considered to be appropriate. The information received relating to risk management, in particular operational and reputational risks, was much improved.
<b>Succession planning and human resource management</b>	Board members felt that the senior management structure and succession planning for executive and key management positions supported the strategic objectives. The succession plans and board succession planning matrix for the appointments to the board and senior management had been developed and had gained a greater level of detail, particularly in relation to developing more granularity on timescales for key board positions. There had been improvements to the visibility of potential internal candidates for succession to the executive team and to their direct reports.
<b>Committees</b>	The composition and performance of the audit, remuneration, nomination, corporate responsibility and treasury committees were considered to be appropriate, and the feedback from committee meetings by committee chairs was full and transparent and meetings chaired effectively. Specific actions identified were as follows: Nomination committee: ensure the focus on senior board succession was maintained over the next 12 months, but also ensure that there was thought given to the skills needed around the board over the next five years; Remuneration committee: to consider the timetable for the review of the committee's external advisers; Audit committee: continue the progress made during the year on making papers more concise; and Corporate responsibility committee: increase the committee's engagement with customer priorities.
<b>Individual directors</b>	The individual performance of the directors was assessed, all of which were considered to be independent and effective, and all directors demonstrated the expected level of commitment to the role. The review of the Chairman's performance (led by the senior independent director) concluded he continued to demonstrate an effective and independent perspective, fulfil the expected commitment to the role and was an effective leader of the board. All directors would be offering themselves for reappointment/election at the 2017 AGM.

# Corporate governance report

2015/16 evaluation recommendations	Actions taken during 2016/17
Strengthen the board with additional skills/experience from an engineering/industrial background.	Alison Goligher was appointed on 1 August 2016 (see page 53).
The board should allow time to consider the customer experience, and the key strategic issues of market reform and competition in the sector.	The board received a paper and presentation on the customer experience programme along with updates on progress. Furthermore, regular updates were provided throughout the year on the group's progress and readiness for market reform and the opening of the industrial market to competition on 1 April 2017.
Continued focus on improvements to keeping board papers concise.	Content, format and length of board papers had improved but the focus for continued improvement should be maintained.
Allow more time for the discussion of key strategic topics at the board strategy away day.	Improvements had been made to the timetable for the board strategy away day to allow more time for discussion of the group's strategic priorities.
Nomination committee: develop a board succession planning matrix and gain an understanding of the granularity of timescales for succession planning.	The succession plans and board succession planning matrix for the appointments to the board and senior management had been developed and had gained a greater level of detail, particularly in relation to developing more granularity on timescales for key board positions.
Remuneration committee: ensure that succession planning activities and remuneration activities were aligned.	The remuneration committee considered succession planning during the nomination process for the Long Term Plan awards made in 2016. In the coming year, as the talent programme at the senior level progresses, the committee will further review the alignment of remuneration to the outcomes of the programme.
Audit committee: review the effectiveness of the assurance of risk management systems, particularly in relation to the oversight of the management of operational and reputational risk.	Regular updates have been provided to the audit committee (and the board) on the implementation of actions identified by Mark Clare, senior independent director, in his review of the 2015 Lancashire water quality incident.
Corporate responsibility committee: review the analysis of reputational risk to ensure alignment with the audit committee.	Changes have been made to risk reporting to improve the presentation of the reputational aspects of risks as appropriate and these are considered at both the audit committee and the corporate responsibility committee.

## Board development

Board directors regularly receive updates to improve their understanding and knowledge about the business and in particular its regulatory environment. As part of the individual directors element of the board evaluation exercise (see page 63) directors are asked to identify any skills or knowledge gaps they would like to address.

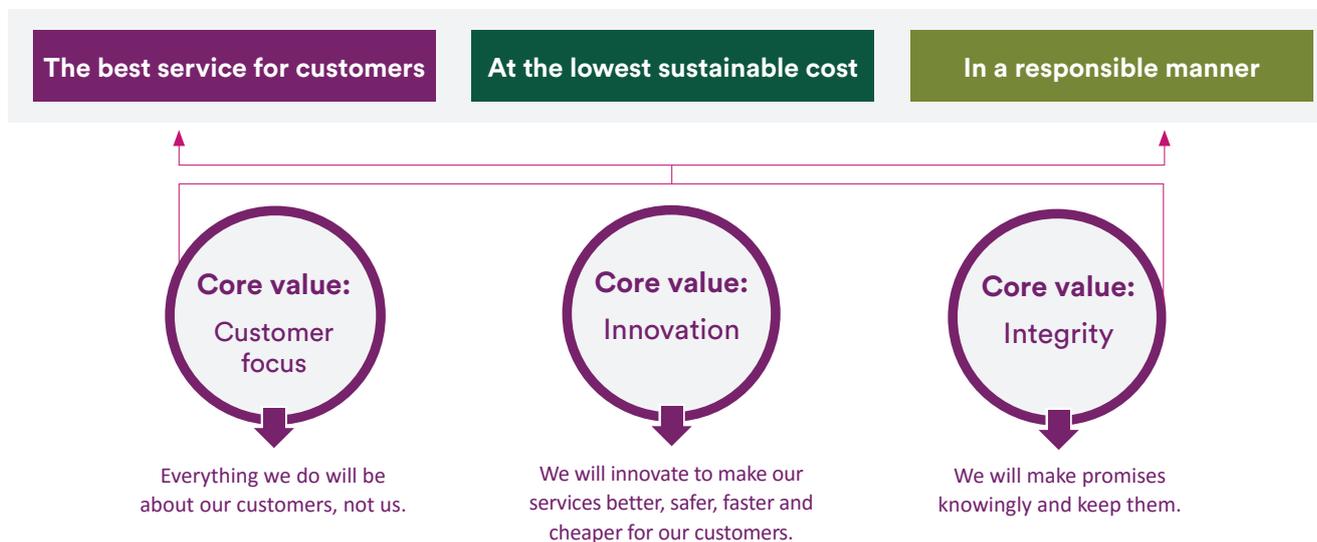
Consideration of environmental and social issues are fundamental to the way in which we operate as a responsible business at United Utilities; such matters are central to board discussions (see the summary of board activity on pages 60 to 61). The board's approach to these matters is reflected in our strategic objective of acting in a responsible manner, and information relating to this can be found throughout the strategic report. Board awareness of in-region environmental and social matters has also been raised during the year by the independent customer challenge group, known as 'YourVoice'. In addition to this less formal approach to board development, during the year the board also received briefings from both Slaughter and May (legal and governance matters) and KPMG (governance changes relating to the audit committee and audit reform) along with a number of other advisers.

Our non-executive directors are conscious of the need to keep themselves properly briefed and informed about current issues and to deepen their understanding of the business. During the year, Sara Weller visited both the Lingley Mere offices and the Water Plus offices in Stoke-on-Trent, to meet with management and discuss customer treatment, competition and capital programmes. She also attended sessions run by Ofwat and received independent remuneration briefings from external sources. Brian May spent a day at the group's Lingley Mere offices where he met with a number of members of the senior management team and had discussions relating to internal audit and risk management, progress with the customer experience, and in relation to Systems Thinking and our approach to the wholesale operations. He also met with our business development director and our IT director. Mark Clare also spent a day visiting the customer operations team based at Lingley Mere.

Following appointment each director will have an induction programme arranged for them in order to help them gain an understanding of the business and the key issues and to provide them with information that will help them to be effective and make a contribution to board debates. Details of Alison Goligher's induction are given on page 70.

## Values and culture

The values identified by the board (see page 57) underpin our strategic objectives:



The United Utilities way of doing things is to act as a responsible business and is set out in our 'Business Principles' document. A copy can be found at:

[corporate.unitedutilities.com/united-utilities-business-principles](http://corporate.unitedutilities.com/united-utilities-business-principles)

In July 2016, the FRC published a report of its observations on 'Corporate Culture and the Role of Boards'. This report defined culture in a corporate context 'as a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders. These stakeholders include shareholders, employees, customers, suppliers and the wider community and environment which are affected by a company's conduct.'

The board's aim is to lead by example and set the standard of behaviour we expect from our employees. By treating our board colleagues

with respect we aim to foster an environment of trust and one that is conducive to open and frank discussions. This approach is in the best interests of our business and all our stakeholders. Furthermore, culture in its various forms/guises is treated as business as usual. Cultural indicators such as customer service, employee matters and risk management form part of the board's regular discussions and further contribute towards our objective of acting responsibly (see the summary of board activity on pages 60 to 61). Our CEO is responsible for cascading our culture and behaviour of acting responsibly throughout the business and he is supported and facilitated in this by the executive and wider management team. As part of their role, we expect our employees to live the values of customer focus, integrity and innovation. More information can be found on our website at:

[corporate.unitedutilities.com/cr-our-values](http://corporate.unitedutilities.com/cr-our-values)

In the table below are examples of how we aim to act responsibly towards our different stakeholders:

<b>How we act responsibly towards our customers</b>	<b>How we act responsibly towards our employees</b>	<b>How we act responsibly towards our other stakeholders (shareholders, environment, communities, and regulators)</b>
<p>We offer 'Priority Services' that customers can register for if they require extra support due to such things as ill health, age related issues, disability, mental health problems, financial worries or language barriers. Our 'Moving Home' services are available to those moving house in our region. We are making improvements to our written communications with customers to make them easier to understand and remove technical jargon along with launching a new customer website and mobile app.</p>	<p>Our offering to employees includes: a competitive base salary; an employee benefits offering; family friendly policies that go beyond the statutory minimum; the opportunity to express their views about the company in the annual employee survey; an employee assistance support helpline; company paid healthcare and the opportunity to join our share incentive plan. Our whistleblowing helpline allows employees to raise any concerns they may have.</p>	<p>Our investor relations team provides a point of contact for investor queries; our sustainability team champions sustainability issues with the business; our stakeholder teams provide support in areas where we are undertaking major capital projects; our communications teams raise awareness and respond to press and media queries; our corporate affairs team provides information to public organisations; and our regulatory team is in constant communication with our various regulators.</p>

We have made significant progress in improving the customer experience and embedding a customer service orientated culture in recent years. On page 32 of the strategic report, details of the KPIs used to monitor customer service can be found. Our employee survey (see page 38 of the strategic report) shows employee engagement at 89 per cent. The management team is working hard to embed these values in our business. Furthermore, with the implementation of our Systems Thinking approach and improving the technology deployed across our asset base during the current regulatory period, we would expect to see further improvements in the standard and efficiency of our service to our customers.

# Corporate governance report

## Nomination committee

To ensure that board members and senior management have the appropriate balance of skills and experience to support the group's strategic objectives.

### Quick facts



- All members of the committee are independent, thus exceeding the Code requirement that a 'majority of members of the nomination committee should be independent non-executive directors'
- The role of the committee is to make recommendations to the board on its composition, balance and membership and on refreshing the membership of the board committees
- The company secretary attends all meetings of the committee
- The business services director, who has responsibility for human resources, regularly attends meetings and is responsible for engaging with executive search recruitment advisers
- The CEO is not a member of the committee, but from time to time is invited to attend. Neither the Chairman nor the CEO would participate in the recruitment of their own successor

### Quick links

Terms of reference –

[corporate.unitedutilities.com/corporate-governance](https://corporate.unitedutilities.com/corporate-governance)

### Dear Shareholder

We have made considerable progress during the year in developing our board succession plans, and we have tried in this report to provide an informative explanation of our succession planning activities that will reassure our stakeholders that these matters are being properly addressed. In many ways, given the nature of the subject matter, it is a difficult topic to report publicly, and on a human level, people's lives and circumstances can change, sometimes at short notice.

As a board that is relatively small in size, succession planning to ensure that board members and senior management have the appropriate balance of skills and experience to support the group's strategic objectives is a matter that the board as a whole considers. We therefore have the benefit of the views and experience of all board members to contribute to the debate. During the year the board has reviewed the people and organisational capability plan twice, in June and in November. The review examined the changing nature of the organisation and move towards digitalisation both internally and externally, and the progress being made to understand the skills and capabilities we need going forwards. In our succession planning we aim to ensure both our board directors and members of the executive team and other senior managers, who are potential successors to the executive team or board, are well equipped with the right skills and experience to address the challenges of our business and, where necessary, address any developmental needs. They also need to be in tune with the culture of the company.

In support of these board discussions, the nomination committee has responsibility for considering the detailed recruitment process for executive and non-executive board appointments and members of the executive team. All the non-executive directors are members of the nomination committee and participate in meetings and in the recruitment process. The nomination committee is supported in the recruitment process by Sally Cabrini, business services director, as part of her human resources responsibilities. The committee has met four times during the year. The meetings discussed and developed our board and executive level succession plans, which address both contingency planning needs and requirements in the short to medium-term. These plans now include more granularity on timescales for key board positions. Additionally, the committee oversaw the appointment process of a new non-executive director.

### Nomination committee members

 Dr John McAdam (chair)	 Alison Goligher (appointed 1 August 2016)
 Dr Catherine Bell (stepped down 22 July 2016)	 Brian May
 Stephen Carter	 Paulette Rowe (appointed with effect from 1 July 2017)
 Mark Clare	 Sara Weller



Read the [Board of directors](#) on pages 52 to 54



**Pictured:** Dr John McAdam, chairman of the nomination committee

Historically, independent non-executive directors at United Utilities have served a term of between seven and nine years, a pattern which has facilitated the refreshing of the board in recent years by one appointment on an annual basis, along with ensuring a high degree of continuity. Notwithstanding this, the specifics of each of the non-executive directors' time of departure has been driven by their own personal circumstances. Serving beyond a nine-year term is identified in the Code as being one of the reasons which could affect a non-executive director's independence. The Code excludes board chairmen from the nine-year rule. As reported last year, Alison Goligher was appointed on 1 August 2016, succeeding Dr Catherine Bell who stepped down at the AGM in 2016. I am pleased to report that Alison has been very proactive in learning about the business and is making a valuable contribution in board meetings. We also recently announced the appointment of Paulette Rowe to join the board with effect from 1 July 2017 as an independent non-executive director. Paulette's first hand regulatory experience will

provide additional perspective in this important area for the group, and her experience of technology driven business transformation will contribute to our operation, through the customer experience programme and our Systems Thinking approach.

Our board diversity policy (see page 69) is taken into account during every candidate selection process. Ultimately, we do strive to appoint the person we believe is best matched to the role in terms of what they have to offer the company and to make a positive contribution to the board conversation and board dynamics. Diversity of outlook and interest is essential to ensuring we have a different variety of views to contribute to discussions. We have revised our target for gender diversity in our board diversity policy, which shall be to maintain at least 25 per cent, and aspire to 33 per cent female representation on our board by 2020.

**Dr John McAdam**  
Chair of the nomination committee

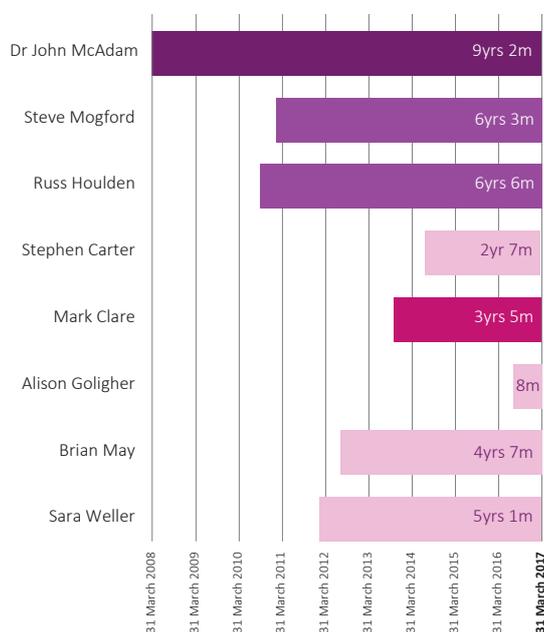
### Main responsibilities of the committee

- › Lead the process for board appointments and make recommendations to the board about filling vacancies on the board, including the company secretary
- › Consider the succession planning of directors and members of the executive team
- › Make recommendations to the board on refreshing the membership of the board's principal committees
- › Review directors' conflict authorisations
- › Consider the request from executive directors for election to the boards of other companies and make a recommendation to the board
- › Consider requests from non-executive directors for the election to the boards of other companies; this role has been delegated to the Chairman (other than in respect of his own position)

# Corporate governance report

## Nomination committee

### Directors' tenure as at 31 March 2017\*



\*Excludes Paulette Rowe who was not appointed until 1 July 2017

### What has been on the committee's agenda during the year

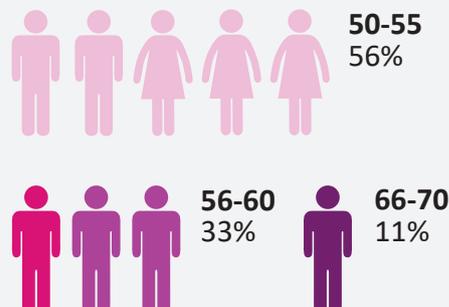
#### Board succession

The committee has further developed the board succession plans during the year, taking into account more granularity around timescales for key board positions, the likely evolution of the business and the changing shape and increasingly competitive nature of the industry expected from 2020 onwards. A succession planning matrix tool (incorporating the skills matrix, see opposite) for board directors is used to support the planning process for board appointments. The succession planning matrix highlights the Code governance requirements; existing directors' terms of appointment and a forecast/anticipated timeframe for when they might leave the business; the projected strategic needs of the business and the resulting preferred experience of any potential new board member; and existing potential internal successors to a role (where identified) and those who could act as an interim should the need arise. A candidate suitable for the role of CEO would need to demonstrate that their management approach would fit with the company's culture of acting responsibly. The committee would seek to consult with the incumbent CEO, given their unique knowledge and perspective of the group, on his view of the needs of the business going forwards. The CEO would not be involved in the appointment process of his successor, nor would the Chairman be involved in the appointment of his successor.

#### Board appointment process

Typically, following board discussions, the nomination committee will be responsible for drafting a brief, setting out the attributes and experience of a preferred candidate supported by the director of business services as part of the human resources function of the role. The brief would be shared with a number of executive search agencies (all of which would be signatories to the voluntary code of conduct on gender diversity for executive search firms) who would be invited to present their understanding of the role

### Age profile



and attributes required. One of these firms would be engaged to conduct the search. Russell Reynolds were involved in Paulette Rowe's recruitment, as they demonstrated the best understanding of the role. Other than providing executive search services on previous occasions, Russell Reynolds has no other connection with the company. A long-list of candidates would then be reviewed by the nomination committee and those identified for a short-list would be invited for interview, initially with the Chairman, the CEO and the business services director. Thereafter, a number of candidates would be invited to meet other non-executive directors and the CFO. Following the interview process, the nomination committee would meet to review and discuss the candidates (with the support of the business services director) taking into account the views of the CEO/CFO and assess the 'best-fit' with the succession planning and skills matrix and then make a recommendation to the board. References would be sought and reviewed by the Chairman prior to an appointment being taken up. A preferred candidate would also meet with representatives of Ofwat.

### Reviewing membership of the principal board committees

The committee considered the membership of the principal board committees, and concluded that, given his financial expertise, it would be beneficial for Brian May to join the remuneration committee to provide a mutual benefit to both the remuneration and audit committees. Paulette Rowe would join the audit committee, where it was felt her experience of regulated services, and the importance of risk and reputation, would be of most benefit to the board. On her appointment, Alison Goligher had been appointed to all the principal board committees. This was unusual at United Utilities but had been done to provide Alison with a window into all the activities of the board. On Paulette joining the board and providing additional resource, it was agreed that Alison should relinquish her responsibilities as a member of the audit committee.

### Skills matrix of board directors

	Finance/ accounting	Utilities	Regulation	Government	Construction/ engineering	Industrial	Customer facing	FTSE companies
Dr John McAdam		✓				✓	✓	✓
Steve Mogford		✓			✓		✓	✓
Russ Houlden	✓	✓	✓			✓	✓	✓
Paulette Rowe			✓		✓		✓	✓
Stephen Carter		✓	✓	✓			✓	✓
Mark Clare	✓	✓	✓		✓		✓	✓
Alison Goligher					✓	✓		✓
Brian May	✓					✓	✓	✓
Sara Weller			✓	✓			✓	✓

### Board diversity

The board diversity policy is to 'ensure the selection process for board candidates provides access to a range of candidates, although any appointments will be made on the basis of equal merit but with due regard for the benefits of diversity on the board, including gender diversity'. As stated by the policy, the board is looking for new directors to bring something different to the board table, be it in terms of experience, skills, perspective or interests.

During the year, we have revised the gender target in our board diversity policy, which is now to maintain our target of at least 25 per cent, and aspire to 33 per cent female representation on the board by 2020.

We are keen to develop our female senior managers so that, over time, they can be considered for executive board appointments or as potential candidates for non-executive directorships in other companies and we have a number of initiatives in place supporting women in the workplace (see page 70). We encourage our senior managers to take on a non-executive directorship role but recognise that the responsibilities of such a role are very much a personal commitment.

### Conflicts of interest and time commitment

The company's articles of association contain provisions which permit unconflicted directors to authorise conflict situations. Each director is required to notify the Chairman of any potential conflict or potential new appointment or directorship, and the board reviews the position of each director annually. No changes were recorded which would impact the independence of any of the directors.

The board does not specify the time commitment it requires from its non-executive directors in taking on the role as they are expected to fulfil it and manage their diaries accordingly. The board is content that none of its directors are over-committed and unable to fulfil their responsibilities as a board director for United Utilities and are not 'overboarded'. Each individual's circumstances are different, as is their ability to take on the responsibilities of a non-executive directorship role. Should a director be unable to attend meetings on a regular basis, not be preparing appropriately or not contributing to board discussions the Chairman would be responsible for discussing the matter with them and agreeing a course of action.

### Summary of board diversity policy

- Ensure the selection process for board candidates provides access to a range of candidates, although any appointments will be made on the basis of equal merit but with due regard for the benefits of diversity on the board, including gender diversity
- Ensure that the policies adopted by the group will, over time, promote gender diversity among senior managers who will in turn aspire to a board position
- In selecting candidates for board positions, only use the services of executive search firms who have signed up to the voluntary code of conduct for executive search firms as recommended by Lord Davies
- Adopt measurable objectives from time to time for achieving gender diversity at board level – which shall be to maintain at least 25 per cent, and aspire to 33 per cent female representation by 2020

### Induction of new non-executive directors

An induction programme is devised for each new non-executive director. It would include one-to-one meetings with the Chairman and each of the existing non-executive directors. They will have one-to-one meetings with the CEO, CFO, managing director of the wholesale business and the company secretary along with other members of the executive team. They will also meet members of the operational teams and visit some of the key operational sites and capital projects to ensure they get a first-hand understanding of the water and wastewater business. New directors receive a briefing on the key duties of being a director of a regulated water company, including the role of the regulated company's holding company, and they will also meet with the director of regulation and representatives of Ofwat.

# Corporate governance report

## Nomination committee

### Alison Goligher: summary of induction

- Met with members of the executive team discussing our business and regulation
- Visited the integrated control centre based in Warrington, meeting staff, and discussing the group's monitoring and control of its water and wastewater network and assets which forms the 'digital brain' of our network
- Attended the AGM as a guest and met with board members
- Met with Sara Weller, chair of remuneration committee, the head of reward and a representative from New Bridge Street as part of her remuneration committee responsibilities
- Had a meeting with the business development director to discuss new initiatives
- Met with the corporate affairs director and head of sustainability in relation to her corporate responsibility committee responsibilities
- Met with the head of customer services to discuss the actions undertaken by the business and its employees to improve their service to customers
- Discussed the wholesale operating model with the wastewater services director and water services director and visited the water and wastewater testing laboratories
- Visited Davyhulme wastewater treatment works and met with the programme services director with a particular focus on the extension of the sludge treatment plant and the offsite design and build approach being used
- Visited Cumbria to view the progress with the extension of the water supply network to ensure the security of water supplies to customers in West Cumbria

### Wider succession and talent management

For a number of years, we have had a written succession plan for our executive directors and other members of the executive team, which now includes more granularity in terms of timescale. This plan identifies an interim internal successor to fill a role in the short-term should the need arise, and the longer term development needs of potential successors to be able to fulfil a role on a more permanent basis. As with all our board appointments, we would always aim to appoint the best person to fulfil a role. It would be common, when recruiting for a senior role, for an external search to be conducted alongside an internal candidate recruitment process.

Any changes that are required to the profile of the management team to reflect the changing needs of the business are considered by the board in the executive succession plan. Succession and development initiatives for senior executives include executive mentoring and international business school training.

During the year, board directors have a number of opportunities to meet with members of the executive team, both formally when senior managers are required to present to the board on matters related to their responsibilities at board meetings, and on more informal occasions such as when they host site visits for board members. Board members also have the opportunity to meet members of the apprentice and graduate population and other employees identified as potential talent within the business.

### What have we done in 2016/17?

#### Improving diversity across the talent pool

In our executive team of eight (including the CEO and CFO), three are women, namely Louise Beardmore (customer services director), Sally Cabrini (business services director) and Gaynor Kenyon (corporate affairs director). We are actively working with these individuals on their personal development plans, which include building their external portfolio and capabilities to take up a non-executive appointment.

Women hold 15 per cent (2016: 21 per cent) of senior leadership positions. We actively support their individual personal development plans, which includes encouraging them to broaden their external network. The 'Women in UU' network is very popular and membership has trebled during the year. This year we are focusing on extending our network to include our partners and making better use of digital media to promote 'Women in UU' externally, with a view to externally enhancing our employer brand. Sally Cabrini, business services director, has been included in the top 50 of the Northern Power Women list, and this year Louise Beardmore has been nominated for inclusion on to the list. We were nominated as a finalist in the large company category of the 2017 Northern Power Women Awards in recognition of the work we are doing to attract and develop female talent.

Our graduate scheme continues to be successful in attracting female applicants; the overall number of female graduates on the scheme is 40 per cent and 36 per cent of our engineering graduates are female.

In 2016, 24 per cent of our intake of apprentices were female, (2015: 30 per cent). Research from the Sector Skills Council for Science, Engineering and Manufacturing Technologies shows the average number of women in apprenticeships is between five and seven per cent. At United Utilities, 15 per cent of applicants were female (2015: 11 per cent) and our total female apprentice population is 22 per cent.

During the year, we have rolled out unconscious bias training to our senior leadership teams to encourage them to consider any bias they may have, not only from a gender perspective, but more broadly. This training will also be provided to high volume recruitment managers.

We are members of Race for Opportunity, part of Business in the Community and the leading organisation for ethnic diversity and inclusion. In 2015, we participated in the annual benchmarking survey and achieved a bronze award. Our aim is to achieve a silver award in 2017.

Our employee-run lesbian, gay, bisexual and transgender network, newly rebranded as 'Identity' has organised a number of employee events and has participated in a number of Pride events during the year in our region. The company has enabled employee representatives of the network to attend the Stonewall conference. Louise Beardmore is the executive sponsor for the network.

## Code principle – Relations with shareholders

### Introduction by Dr John McAdam

**“During the year, along with the company secretary, I met with several investors and we discussed a number of topics, the details of which I shared with my board colleagues. Such face-to-face meetings are extremely useful in providing the board with a balanced understanding of the views of major shareholders.”**

The board as a whole accepts its responsibility for engaging with shareholders and is kept fully informed about information in the marketplace including:

- › the investor relations adviser produces an annual survey of investors’ views and perceptions about United Utilities, the results of which are presented to and discussed by the board;
- › the board receives regular updates and feedback on activities within investor relations and reports from sector analysts to ensure that the board maintains an understanding of investors’ priorities; and
- › the executive and non-executive directors are available to meet with major shareholders and institutional investors – this is also one of the specific roles of the senior independent director.

During the year, the role of adviser providing investment research to the company was re-tendered due to the service being considered in accordance with the EU Audit Directive and Audit Regulation (see page 77) to be a prohibited non-audit service, with the incumbent, Makinson Cowell, being part of the KPMG organisation. Rothschild Investor Advisory were engaged to provide these services with effect from 1 April 2017.

### Institutional investors

We are always keen to engage with our shareholders, hear their views and update them on developments in our business. As well as current investors, we engage actively with institutional investors who do not currently hold shares in United Utilities, as we are keen to ensure our business is well understood across the investment community, and to hear and discuss the views of all investors.

We have an active investor relations programme, which includes:

- › a regular schedule of meetings between the CEO and CFO and representatives from our major shareholders, supplemented with meetings hosted by our investor relations team;
- › presentations by the CEO and CFO to groups of institutional investors, both on an ad hoc basis and linked to our half and full year results announcements;
- › the programme covers a range of major global financial centres, typically including the UK, Europe, North America and the Asia Pacific region;
- › regular feedback is provided to the board on the views of our institutional investors following these meetings; and
- › close contact is also maintained between the investor relations team and a range of City analysts that conduct research on United Utilities.

In 2016/17, through our investor relations programme, we met or offered to meet with 42 per cent, by value, of the overall shareholder base, which represents 74 per cent of the targetable institutional shareholder base (when adjusting for shareholders who do not typically meet with companies, such as indexed funds).

Frequent areas of common interest arising in meetings with investors include operational and environmental performance, customer service, capital investment, efficiency initiatives, regulatory performance and regulatory changes. Investors are always keen to observe financial stability and are interested in the level of gearing versus regulatory assumptions; cost of finance; our debt portfolio and debt maturity profile; future financing requirements; and dividends. The outcome of the price review, covering the 2015-20 period, remains a key area of interest, and investors are keen to understand how the company is performing relative to the price review allowances and targets each year, along with the potential implications of regulatory change and political risk.

### Retail shareholders

Despite the privatisation process being over 25 years ago, we have retained a large number of individual shareholders with registered addresses in the North West of England – in fact over 50 per cent of registered shareholdings on the share register. We have historically always held our AGM in our region in Manchester, which enables our more local shareholders, many of whom are also our customers, to attend the meeting. We endeavour to hold the meeting at a venue which is both centrally located in the city (to enable shareholders to use public transport should they so wish) whilst being mindful of the costs.

There is a considerable amount of information on our website, including our online report which provides information on our key social and environmental impacts and performance during the year. Together with the annual and half-yearly results announcements, our annual report and financial statements are available on our website; these are the principal ways in which we communicate with our shareholders. Our company secretariat and investor relations teams, along with our registrar, Equiniti, are also on hand to help our retail shareholders with any queries. Information for shareholders can also be found on the inside back cover of this document, with a number of useful website addresses.

### Outcome of 2016 AGM

At the 2016 AGM votes were cast in relation to approximately 61 per cent of the share capital. All 17 resolutions were passed by the required majority. Votes were cast in favour of the reappointment of the board directors as follows:

Dr John McAdam	<b>97.49%</b>	Brian May	<b>99.55%</b>
Stephen Carter	<b>99.62%</b>	Steve Mogford	<b>99.80%</b>
Mark Clare	<b>99.63%</b>	Russ Houlden	<b>99.46%</b>
Sara Weller	<b>99.62%</b>		

Alison Goligher and Paulette Rowe will stand for election by shareholders for the first time at the 2017 AGM.

# Corporate governance report

## Relations with other providers of capital

Running a water and wastewater business, by its very nature, requires a long-term outlook. Our regulatory cycle is based on five-year periods, and we raise associated funding in order to build and improve our water and wastewater treatment works and associated network of pipes for each five-year cycle. We are heavily reliant on successfully acquiring long-term funding from banks and the debt capital markets to fund our capital investment programme and refinance upcoming debt maturities.

This requires long-term support from our credit investors who invest in the company by making term funding available in return for receiving interest on their investment and repayment of principal on maturity of the loans or bonds. We arrange term debt finance in the bond markets (with maturities typically ranging from seven years to up to 50 years at issue). Debt finance is raised via the group's London listed multi-issuer Euro Medium Term Note Programme, which gives us access to the sterling and euro public bond markets and privately arranged note issues. Committed credit facilities are arranged with our relationship banks on a bilateral basis. Additionally, the European Investment Bank (EIB), which is the financing arm of the European Union (EU), is our single biggest lender, currently providing around £2 billion of debt and undrawn facilities to support our capital investment programmes (past and present). Following the 2016 referendum regarding the UK exiting the EU (Brexit), it is likely that the EIB will significantly curtail new lending into the UK once Brexit has been effected. We therefore expect that post-Brexit, further loans from the EIB will not be available and our existing loan portfolio with the EIB will enter into 'run-off' in line with the scheduled maturities of each loan. The group is therefore likely to access the debt capital markets on a more regular basis post-Brexit. The group currently has gross borrowings of circa £7,384 million.

Given the importance of debt funding to our group, we have an active credit investor programme coordinated by our group treasury team, which provides a first point of contact for credit investors' queries and maintains a dedicated area of the company's website. One-to-one meetings are held with credit investors through a programme aimed at the major European fund managers known to invest in corporate bonds that may be existing holders of the group's debt or potential holders. Regular mailings of company information are sent in order to keep credit investors informed of significant events. The treasury team has regular dialogue with the group's relationship banks and the EIB and the credit rating agencies. More information can be found on our website at: [corporate.unitedutilities.com/93](http://corporate.unitedutilities.com/93)

## Code principle – Accountability

### Introduction by Dr John McAdam

**“One of the actions that was highlighted by our internal investigation into the Lancashire water quality incident in August 2015 was providing increased focus on reputational and operational risks. Accordingly, the information received by the board on the risk profile of the group has been broadened considerably.”**

## Board's approach to risk management and internal control

The board is responsible for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The board is also responsible for ensuring that the company's risk

management and internal control systems are effectively managed across the business and that they receive an appropriate level of scrutiny and board time. The group's risks predominantly reflect those of all regulated water and wastewater companies. These generally relate to the failing of regulatory performance targets or failing to fulfil our obligations in any five-year planning cycle, potentially leading to the imposition of fines and penalties in addition to reputational damage.

During the year, the board reviewed the effectiveness of the risk management systems, including financial, operational and compliance controls and the progress made to address the key recommendations of the investigation undertaken by Mark Clare, senior independent director, relating to the Lancashire water quality incident in 2015. This investigation identified that the risk management framework was robust whilst identifying a number of improvement opportunities, namely: better coordination of drinking water safety plans within wholesale; improved application by business units of the risk management process; further embedding existing risk management processes within wholesale; and improving system integration. All the actions have either been completed or were on target to be completed by their forecast completion date.

The board, following the review by the audit committee, concluded that it was appropriate to adopt the going concern basis of accounting (see page 131). Similarly, in accordance with the principles of the Code, the board concluded, following the recommendation from the audit committee, that it was appropriate to provide the long-term viability statement (see page 73). Assurance supporting these statements was provided by the review of: the group's key financial measures and contingent liabilities; the key credit financial ratios; the group's liquidity and ongoing ability to meet its financial covenants. As part of the assurance process, the board also took into account the principal risks and uncertainties facing the company, and the actions taken to mitigate those risks. These principal risks and uncertainties are detailed on pages 48 to 49, as are the risk management processes and structures used to monitor and manage them. Biannually, the board receives a report detailing management's assessment of the most significant risks facing the company. The report gives an indication of the level of exposure, subject to the mitigating controls in place, for the risk profile of the group. This now provides the board with information in two categories – group-wide business risks and wholesale operational risks. The board also receives information during the year from the treasury committee (to which the board has delegated matters of a treasury nature – see the structure diagram on page 59) including such matters as liquidity policy, the group's capital funding requirements and interest rate management.

## Review of the effectiveness of the risk management and internal control systems

Taking into account the information on principal risks and uncertainties provided on pages 48 to 49, and the ongoing work of the audit committee in monitoring the risk management and internal control systems on behalf of the board (and for whom the committee provides regular updates, see pages 80 to 81), the board:

- › is satisfied that it has carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; and
- › has reviewed the effectiveness of the risk management and internal control systems including all material financial, operational and compliance controls (including those relating to the financial

reporting process) and no significant failings or weaknesses were identified. After review, it was concluded that through a combination of the work of the board, the audit committee and the UUW board (with specific responsibility for operational and compliance controls), the company's risk management and internal controls were indeed effectively monitored throughout the year.

In the review of the effectiveness of risk management and internal controls systems the board also took into account:

- › the biannual review of significant risks;
- › the oversight of treasury matters;
- › reviewing and assessing the activities and effectiveness of internal audit;
- › reviewing management's internal control self-assessment;
- › reviewing reports from the group audit and risk board;
- › reviewing the outcome of the biannual business unit risk assessment process; and
- › reviewing the business risk management framework supported by the work of the independent reviewer (see page 81).

### Long-term viability statement

The directors have assessed the viability of the group, taking account of the group's current position, the potential impact of the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions. Based on this assessment, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the five-year period to March 2022.

The long-term planning detailed on pages 26 to 29 assesses the group's prospects and establishes its strategy over a long-term time horizon, proving a framework for the group's strategic planning process. The viability statement has been based on the group's strategic planning process which is aligned to the price control period, the group's liquidity position providing headroom to cover its projected financing needs through until mid-2018 and the group's robust capital solvency position with a debt to RCV ratio of around 60 per cent, providing considerable headroom within which to increase medium-term liquidity if required.

The group has a proven track record of being able to raise new forms of finance in most market conditions, and expects to continue to do so into the future. In addition, the board has considered the protections which exist from the regulatory and economic environment within which it operates. From an economic perspective, given the nature of water and wastewater services, threats to the group's viability from risks such as reduced market share, substitution of services and reduced demand are low compared to those faced by many other industries. From a regulatory perspective the group benefits from a rolling 25-year licence which, coupled with the price control set by Ofwat, provides a high degree of certainty of cash flows during the current price control period (which runs to March 2020), while between price control periods there exists additional protection afforded by Ofwat's primary legal duty to ensure that water and wastewater companies are able to finance their functions. For these reasons the board considers it appropriate to provide a medium-term viability statement of five years.

The directors have assessed the group's viability considering the principal risks as set out on pages 48 to 49, and its ability to absorb a number of severe but reasonable scenarios. These include political and regulatory risks, as well as the potential for a restriction to the availability of financing resulting from a global capital markets crisis. The viability assessment has considered the potential impacts of these risks on the group's business model, future performance, solvency and liquidity over the period. As well as the protections which exist from the regulatory environment within which it operates, a number of mitigating actions are available in the extreme scenarios considered, including the raising of new finance, capital programme deferral, the close-out of derivative asset positions and the restriction of dividend payments. These actions provide the group with significant scope to improve its liquidity and capital position to further absorb such threats.

The directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the basis of preparation paragraph in the accounting policies section of the accounts.

 Read the [Principal risks and uncertainties](#) on pages 48 to 49

## Code principle – Remuneration

### Introduction by Dr John McAdam

**“Our remuneration policy has been designed in order to promote the long-term success of the company and delivery of the business strategy, with a significant proportion of senior executives' pay being performance related.”**

 Read the [Remuneration committee report](#) on pages 86 to 109

# Corporate governance report

## Audit committee

Much of the work of the committee is necessarily targeted at the regulated activities of United Utilities Water Limited, which represent over 98 per cent of group revenues.

### Quick facts



- Brian May has chaired the committee since July 2013. He is a serving finance director of a FTSE 100 company and chartered accountant and is considered by the board to have recent and relevant financial experience
- All members of the committee are independent non-executive directors
- Other regular attendees at meetings include the Chairman, the CEO, the CFO, the company secretary, the head of audit and risk, the group controller, and representatives from the external auditor KPMG LLP (KPMG)
- KPMG and the head of audit and risk are both afforded time with the committee to raise freely any concerns they may have without management being present
- The committee is authorised to seek independent advice as it sees fit, but has not done so during the year

### Quick links

Terms of reference –

[corporate.unitedutilities.com/corporate-governance](https://corporate.unitedutilities.com/corporate-governance)

### Dear Shareholder

This year we are again required to report against the 2014 version of the Code. However, we are content that we comply with the new 2016 Code provision that the ‘committee as a whole should have competence relevant to the sector in which the company operates’ (see page 56). As chairman of the committee, I fully endorse the view of the board that all the members of the committee have competencies relevant to the utilities sector and the business of the United Utilities group. All members contribute to the work of the committee and have the skills and necessary degree of financial literacy. As non-executive directors, my colleagues and I are of an independent mindset and would have no hesitation in seeking clarification and a full explanation from management or the external auditor on any matter we feel necessary.

Although the audit committee has specific responsibilities rooted in reviewing the group’s financial statements and reviewing the internal assurance work and external audit of those financial statements, the committee also reviews the internal control and risk management processes, leaving the review of the significant risks to be undertaken by the board. Last year, the board engaged an independent review of the business risk management framework which was considered to be satisfactory but recommended a number of actions to enhance the process. The audit committee was asked to monitor the progress of the implementation of the actions and I can report that all actions have either been completed or were on target to be completed by their forecast completion date (see page 72). Our 2017 long-term viability statement can be found on page 73; we are content that a medium-term period of five years is appropriate to assess the group’s viability given the nature of the business and the underlying protection afforded by Ofwat’s primary legal duty to ensure that water and wastewater companies are able to finance their functions.

Much of the work of the committee is necessarily targeted at the regulated activities of UUW, which represent over 98 per cent of group revenues and is a reflection of our commitment to safeguarding the interests of our customers.

### Audit committee members

-  Brian May (chair)
-  Dr Catherine Bell (stepped down 22 July 2016)
-  Stephen Carter
-  Alison Goligher (appointed 1 August 2016, relinquished 1 July 2017)
-  Paulette Rowe (appointed with effect from 1 July 2017)



Read the biographies of the [Board of directors](#) on pages 52 to 54



**Pictured:** Brian May, chair of the audit committee.

The FRC Corporate Reporting Review team reviewed our 2016 annual report and accounts; further information can be found on page 79.

We have again worked this year to enhance this report and make it more informative for the reader and we continue to be committed to providing meaningful disclosure of the committee's activities. As chair of the audit committee, I am committed to ensuring that the committee's agenda is kept under review and keeps abreast of relevant developments. The details of the annual evaluation process of the committee's performance, which was conducted alongside the board evaluation process, can be found on page 63.

The following report was approved by the committee at its meeting held on 15 May 2017.

**Brian May**  
Chairman of the audit committee

## Main responsibilities of the committee

- › Make a recommendation to the board for the appointment or reappointment of the auditor, and to be responsible for the tender of the audit from time to time and to agree the fees paid to the auditor
- › Establish policies for the provision of any non-audit services by the auditor
- › Review the scope and the results of the annual audit and report to the board on the effectiveness of the audit process and how the independence and objectivity of the auditor has been safeguarded
- › Review the half-year and annual financial statements and any announcements relating to financial performance, including reporting to the board on the significant issues considered by the committee in relation to the financial statements and how these were addressed
- › Review the scope, remit and effectiveness of the internal audit function and the group's internal control and risk management systems
- › Review the group's procedures for whistleblowing, reporting fraud and other inappropriate behaviour and to receive reports relating thereto
- › Report to the board on how it has discharged its responsibilities

# Corporate governance report

## Audit committee

### What has been on the committee's agenda during the year

The committee has an extensive agenda of items of business which it deals with in conjunction with senior management, the auditor, the internal audit function and the financial reporting team. There were four scheduled meetings of the committee during the year. Items of business considered by the committee during the year included:

- › considering the issues and findings brought to the committee's attention by the internal audit team and satisfying itself that management has resolved or is in the process of resolving any outstanding issues or concerns;
- › reviewing the reports from the financial reporting team on the financial statements, including the UUW financial statements and other regulatory reports, and considering matters such as the accounting judgements and policies being applied and how the statutory audit contributed to the integrity of the financial reporting;
- › reviewing the proposed audit strategy for the 2016/17 statutory audit, including the level of materiality applied by KPMG, audit reports from KPMG on the financial statements and tasking management to resolve any issues relating to internal controls and risk management systems;
- › reviewing the going concern and longer term viability assessments prior to making its recommendations to the board and the assurance provided in undertaking the viability assessment;
- › agreed the appointment of the new lead audit partner;
- › monitoring the progress of the implementation of actions identified by the externally facilitated review of the business risk management framework which the board commissioned in response to the 2015 Lancashire water quality incident;
- › reviewed the statutory audit fee for the year 2016/17;
- › reviewed and approved the non-audit services and related fees provided by the statutory auditor for the year 2016/17; approval of a revised policy on non-audit services provided by the auditor for 2017/18 to reflect the European Union Audit Directive and Audit Regulation which came into force in the UK from 17 June 2016 and applies to audits for financial years beginning on or after that date;
- › monitoring incidents of whistleblowing and fraud reporting;
- › biannual oversight and monitoring of the group's compliance with the Bribery Act which the board reviews annually;
- › overseeing and approving the strategic internal audit planning approach and reviewing reports on the work of the internal audit function from the head of audit and risk. A new system of grading for internal audit reports was introduced during the year;
- › reviewing the quality and effectiveness of internal audit; and
- › reviewing the committee's terms of reference and the conclusions of the committee's annual evaluation. The internally facilitated evaluation was undertaken as part of the overall board evaluation (see page 63). The review explored: time management and the composition of the committee; the committee's processes and support; and the agenda and work of the committee. It was concluded that the committee continued to be effective.

### How we assessed whether 'the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'

The committee, further to the board's request, has reviewed the annual report and financial statements with the intention of providing advice to the board on whether, as required by the Code, 'the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'.

To make this assessment, the committee received copies of the annual report and financial statements to review during the drafting process to ensure that the key messages being followed in the annual report were aligned with the company's position, performance and strategy being pursued and that the narrative sections of the annual report were consistent with the financial statements. The significant issues considered by the committee in relation to the financial statements were consistent with those identified by the external auditor in their report on pages 120 to 123.

The committee concluded that the key performance indicators (KPIs) included in the strategic report (see pages 32 to 33) were, amongst others, those used by management and reflected the measures to be monitored by Ofwat during the 2015-20 period.

In addition, the committee was satisfied that all the key events and issues which had been reported to the board in the CEO's monthly report during the year, both good and bad, had been adequately referenced or reflected within the annual report.

### How we assessed the effectiveness of the external audit process

The committee, on behalf of the board, is responsible for the relationship with the external auditor, and part of that role is to examine the effectiveness of the audit process.

Audit quality is a key requirement. Prior to the statutory audit, at the half-year, KPMG presented the strategy and scope of the audit for the financial year, highlighting any areas requiring special consideration. KPMG then reported against this audit scope at subsequent committee meetings.

On completion of the audit at the full-year, all members of the committee, as well as key members of the senior management team and those who regularly provide input into the audit committee or have regular contact with the auditor, were required to complete a questionnaire seeking their views on how well KPMG performed the year-end audit. Views of the respondents were sought in respect of: the robustness of the audit process; the quality of the delivery of the audit; the expertise of the audit team conducting the audit and that the degree of professional scepticism applied by the auditor was appropriate; the appropriateness of the communication between the committee and the auditor in terms of technical issues; the quality of the service they gave; and their views on the quality of the interaction between the audit partner, the audit director and the company. The feedback was collated and presented to the committee's meeting

in November 2016, at which the conclusions were discussed and any opportunities for improvement brought to the attention of the external auditor. During the year, the FRC also undertook a review of certain aspects of KPMG's audit of United Utilities Group PLC for the year ended 31 March 2016. We have discussed the review findings with the FRC, enabling the Committee to challenge KPMG robustly in relation to the points raised, and satisfy itself that KPMG had taken appropriate action to enhance the quality of the audit process for the 2017 financial year.

Private meetings are held at each committee meeting between the audit committee and the representatives of the external auditor without management being present in order to encourage open and transparent feedback by both parties.

Notwithstanding the points raised by the FRC in relation to KPMG's audit of the 2016 annual report, the committee concluded that the overall external audit process and services provided by KPMG were satisfactory and effective.

## How we assessed the independence of our external auditor

There are two aspects to auditor independence that the committee monitors.

First, in accordance with the Auditing Practices Board's Ethical Standards, KPMG has to implement rules and requirements such that none of its employees working on our audit can hold any shares in United Utilities Group PLC. KPMG is also required to tell us about any significant facts and matters that may reasonably be thought to have an impact on its independence or on the objectivity of the lead partner and the audit team. The lead partner must change every five years and the quality review partner, who reviews the judgements of the audit team actually doing the audit, rotates every seven years along with other partners and staff in senior positions involved in the engagement.

Secondly, the committee considers and approves all the fees that it pays for audit, audit-related and non-audit services from KPMG. KPMG is prohibited from providing certain services to the group, such as operational consulting, internal audit services and strategic planning support, as it is felt that these types of services could impede their independence. Furthermore, auditor independence is also safeguarded by limiting the value of non-audit services performed by the external auditor, which should not ordinarily exceed 100 per cent of the audit fee. The committee has discretion in exceptional circumstances, or where a compelling commercial justification can be provided, for this cap on non-audit fees to be exceeded. The CFO could pre-approve expenditure in respect of non-audit services, such as tax compliance work, of up to £100,000. Thereafter, any fees for non-audit services up to 100 per cent of the audit fee cap could be approved by the committee chair. Any such fees are reported to the committee for review. These arrangements were in place until 31 March 2017.

The EU Audit Directive (2014/56/EU) and Audit Regulation (537/2014) (the Regulation) came into force in the UK on 17 June 2016 and applies to audits for financial years beginning on or after that date. Guidance was issued under the FRC's Revised Ethical Standards 2016 (FRC's Ethical Standards), which prohibit the statutory auditor from providing certain non-audit services to public interest entities (i.e. United Utilities Group PLC) as such services could impede their independence. Historically, the group has engaged Makinson Cowell (a subsidiary of KPMG) to provide it with investor relations services. With effect from 1 April 2017 such services were regarded as prohibited in accordance with the Regulation. As a result, with effect from 1 April 2017, Makinson Cowell no longer provided investor relations services to the group; a tender process was conducted appointing an alternative supplier. In response to the EU Audit Directive and Audit Regulation, the FRC's Ethical Standards have clarified that in the future non-audit services will be subject to a fee cap of no more than 70 per cent of the average annual statutory audit fee for the three consecutive financial periods preceding the financial period in which the cap will apply. The cap will first apply for the group in the year ending 31 March 2021 and, as such, the year ending 31 March 2018 will be the first year of the initial three-year rolling period over which the annual statutory audit fee will be measured for this purpose. The committee has therefore revised its non-audit services policy incorporating the 70 per cent fee cap as described above with effect from 1 April 2017. Furthermore, a limit of £10,000 will be applied for individual items that the CFO can approve, with individual items in excess of £10,000 requiring the approval of the committee.

As part of UUW's licence conditions it is required to prepare audited regulatory accounts, which are derived from its statutory financial statements. The licence stipulates that these regulatory accounts are required to be audited by the appointed statutory auditor and, as such, regulatory audit services will not form part of the non-audit services subject to the 70 per cent cap.

Fees paid to KPMG also include non-audit services in relation to UUW regulatory assurance work that is separate to the regulatory audit. Fees for non-audit services are shown in the bar chart on page 78.

Taking into account our findings in relation to the effectiveness of the audit process and in relation to the independence of KPMG, the committee was satisfied that KPMG continues to be independent, and free from any conflicting interest with the group. As a result, the committee recommended to the board that KPMG be proposed for reappointment at the forthcoming AGM in July 2017. There are no contractual obligations that restrict the committee's choice of external auditor and no auditor liability agreement has been entered into.

# Corporate governance report

## Audit committee



(1) Prior year comparatives in the above table have been re-presented to reflect the classification of services provided by the auditor that will be adopted prospectively in accordance with the audit committee's policy.

### Audit tender

Both the Code and the Competition and Market Authority's Statutory Audit Services Order (the Order)\* cites the responsibility for the process and implementation of auditor appointment to rest with the audit committee. The Order requires that FTSE 350 companies should put the external audit contract out to competitive tender at least every 10 years. The Order promotes audit tendering every five years through a 'comply or explain' requirement with mandatory tendering after 10 years. Further legislation has been enacted by The Statutory Auditors and Third Country Auditors Regulations 2016, which overlaps the Code and the Order and requires mandatory tendering every 10 years and a 20-year maximum term of engagement.

The Order requires that a company that has not competitively tendered its audit services contract in the previous five years, should explain in the fifth (and subsequent years) why this is in the best interests of the company's shareholders. KPMG commenced their appointment as auditor and presented their first report to shareholders for the year ended 31 March 2012, following a tender process for statutory audit services in 2011. The audit committee last undertook an audit tender review in September 2015. The committee took into consideration, amongst other things, audit quality, auditor independence, the cost of the audit and the likely cost and time involved in a tender process. It also reviewed when the most appropriate point in the regulatory cycle would be to conduct an audit tender, given the benefits of having an experienced audit team in place in the run-up to the next price determination in 2019. The committee's audit tender review concluded that the quality of the audit received from KPMG was satisfactory and that KPMG demonstrated an independent approach and operated in accordance

with the Ethical Standards of the Auditing Practices Board ('APB ethical standards'). In accordance with APB ethical standards, the lead audit partner must change every five years; the lead audit partner has indeed been replaced for these 2016/17 financial statements. Bill Meredith, the new lead audit partner, has considerable audit experience of other FTSE 100 utility companies. In September 2015, the committee also agreed that the fee charged for auditing services was competitive and represented value for money, and that it would not be efficient use of the committee's time, nor associated cost to the company, to conduct a tender process for the audit services contract.

The 2017 year end audit has been KPMG's sixth consecutive year in office as statutory auditor. As determined by the September 2015 audit tender review, the committee next intends to undertake a competitive tender, most probably during 2020, for statutory audit services for the financial year ended 31 March 2022. United Utilities has complied fully with the provisions of the Order for the year ended 31 March 2017.

\* The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

## Significant issues considered by the committee in relation to the financial statements and how these were addressed

In relation to the group's financial statements, the committee reviewed the following principal areas of judgement (as noted in the accounting policies):

### Capitalisation of fixed assets

Fixed assets represent a subjective area, particularly in relation to costs permitted for capitalisation and depreciation policy.

- › In considering the work performed by KPMG during the year in this area, the committee assessed the reasonableness of the group's capitalisation policy and the basis on which expenditure is determined to relate to the enhancement or maintenance of assets. These were both determined to be appropriate
- › The committee also reviewed the recovery of the capital overhead rate which management has applied during the year and which the committee had approved in the year ended 31 March 2015 for the five-year regulatory period ending 31 March 2020. The committee concluded that the rate still remained appropriate

### Revenue recognition and allowance for doubtful receivables

Due to the nature of the group's business, the extent to which revenue is recognised and doubtful customer debts are provided against is an area of considerable judgement and estimation.

- › The committee reviewed the current levels of doubtful debt and credit note provisioning (see note 15 for more detail). The committee challenged management over the adequacy of the overall levels of provisioning following these reviews and were satisfied that the resulting net debtor balance was appropriate

### Retirement benefits

The group's defined benefit retirement schemes are an area of considerable judgement, the performance and position of which is sensitive to the assumptions made.

- › The committee sought from management an understanding as to the factors which led to the significant decrease in the IAS 19 net retirement benefit surplus during the period and noted that the scheme specific funding basis had not been impacted by this volatility. Management presented an explanatory note (see page 160) in order to communicate most effectively what is a complex area for the benefit of the group's stakeholders. The committee was satisfied with the explanations provided by management and following a review of the explanatory note approved its inclusion in the financial statements
- › The committee reviewed the methodology and assumptions used in calculating the defined benefit scheme surplus (see note A5 for more details). The group employs the services of an external actuary to perform these calculations and determine the appropriate assumptions to make. KPMG presented a report showing how the assumptions applied compared to their client base. After considering the above, the committee concluded that the approach taken and assumptions made were appropriate and fairly balanced in determining the net retirement benefit surplus

### Provisions and contingencies

The group makes provisions for contractual and legal claims which, by their nature, are subjective and require management to arrive at a best estimate as to the probable outcomes and costs associated with each individual case.

- › The committee received regular updates on new and existing claims being made against the group and the extent to which these have been provided for (see note 20 for details). The committee focused their attention on the more significant items and discussed the judgements made by management in arriving at appropriate provisions in relation to these matters
- › Based on the facts behind each provision and taking account of any relevant legal advice that may have been received as well as the past experience of management in making such provisions and challenging where necessary the views taken by management and through the assurance provided by KPMG who cover these as part of their audit, the committee concluded that the provisions management had made were appropriate

### Derivative financial instruments

The group has a significant value of swap instruments, the valuation of which is based on models which require certain judgements and assumptions to be made. Management performs periodic checks to ensure that the model derived valuations agree back to third party valuations and KPMG check a sample against their own valuation models. It was confirmed to the committee that such testing had been undertaken during the year and there were no significant issues identified.

### Taxation

The committee considered the tax risks that the group faces and the key judgements made by management underpinning the provisions for potential tax liabilities and deferred tax assets. In addition, the committee took account of KPMG's assessment of these provisions. Based on the above, the committee was satisfied with the judgements made by management.

### Underlying operating profit adjustments

During the year, the committee considered and challenged management's treatment of items as adjustments to underlying operating profit and satisfied itself that those items being reported as adjustments met the requirements of the group's policy.

### Interactions with the Financial Reporting Council (FRC)

During the year, the FRC undertook a review of the United Utilities Group PLC annual report and accounts for the year ended 31 March 2016, which resulted principally in queries relating to disclosures. These queries were all resolved to the FRC's satisfaction. To provide greater clarity the group has provided enhanced, voluntary disclosures on these and other matters in this year's financial statements. The review has subsequently been closed. The FRC noted that their review did not provide assurance that the 2016 annual report and accounts is materially correct as their role is not to verify the information included therein but rather to consider compliance with reporting requirements and stimulate improvements in the quality of corporate reporting.

During the year, the FRC also undertook a review of certain aspects of KPMG's audit of United Utilities Group PLC for the year ended 31 March 2016. We have discussed the review findings with the FRC, enabling the Committee to challenge KPMG robustly in relation to the points raised, and satisfy itself that KPMG had taken appropriate action to enhance the quality of their audit process for the 2017 financial year.

# Corporate governance report

## Audit committee

**The main features of the group's internal controls and risk management systems are summarised below:**

### **a. Internal audit function**

The internal audit function is a key element of the group's corporate governance framework. Its role is to provide independent and objective assurance, advice and insight on governance, risk management and internal control to the audit committee, the board and to senior management. It supports the organisation's vision and objectives by evaluating and assessing the effectiveness of risk management systems, business processes and key internal controls.

In addition to reviewing the effectiveness of these areas and reporting on aspects of the group's compliance with them, internal audit makes recommendations to address any key issues and improve processes. Once any recommendations are agreed with management, it monitors their implementation and reports to the committee on progress made at every meeting.

A five-year strategic audit planning approach is applied. This facilitates an efficient deployment of internal audit resource in providing assurance coverage over time across the whole business, as well as greater variation in the nature, depth and breadth of audit activities. This strategic approach supports the annual audit plan, which is then endorsed by management, and which the committee also approves. The plan focuses the team's work on those areas of greatest risk to the business. Building on the strategic planning approach, the development of the plan considers risk assessments, issues raised by management, prior audit findings and the cyclical review programme. The in-house team is expanded as and when required with additional resource and skills sourced from external providers – primarily PwC at present. The committee keeps the relationship with PwC under review to ensure the independence of the internal audit function is maintained. In the course of its work, the internal audit function also liaises with the statutory auditor, discussing relevant aspects of their respective activities which ultimately supports the assurance provided to the audit committee and board.

### **b. Assessing the effectiveness of the internal audit function**

The effectiveness of the internal audit function's work is continually monitored using a variety of inputs including the ongoing audit reports received, the audit committee's interaction with the head of audit and risk, an annual review of the department's internal quality assurance report, annual stakeholder surveys in which committee members also participate as well as any other periodic quality reporting requested. In addition, during 2015, the quality and effectiveness of the internal audit function was externally assessed. Taking all these elements into account, the committee concluded that the internal audit function was effective and appropriate resources were available as required.

Internal audit, led by the head of audit and risk, covers the whole of the group's activities and reports to the committee and functionally to the CFO. The head of audit and risk attends all scheduled meetings

of the audit committee, and has the opportunity to raise any matters with the members of the committee at these meetings without the presence of management. He is also in regular contact with the chair of the committee outside of the committee meetings.

### **c. Risk management systems**

The committee receives updates and reports from the head of audit and risk on activities relating to the company's risk management systems and processes at every meeting. These are then reported to the board, as appropriate. The group designs its risk management activities in order to manage rather than eliminate the risk of failure to achieve its strategic objectives.

The CFO has executive responsibility for risk management and is supported in this role by the head of audit and risk and the corporate risk manager and his team. The group audit and risk board (GARB) is a sub-committee of the executive team. The GARB meets quarterly and reviews the governance processes and the effectiveness and performance of these processes along with the identification of emerging trends and themes within and across the business. The work of the GARB then feeds into the information and assurance processes of the audit committee and into the board's assessment of risk exposures and the strategies to manage these risks.

Supplementing the more detailed ongoing risk management activities within each business area, the biannual business unit risk assessment process (BURA) seeks to identify how well risk management is embedded across the different teams in the business. The BURA involves a high level review of the effectiveness of the controls that each business unit has in place to mitigate risks relating to activities in their business area, to encourage the identification of new and emerging risks and generally to facilitate improvements in the way risks are managed. The outcome of the BURA process is communicated to the executive team and the board. This then forms the basis of the determination of the most significant risks that the company faces which are then reviewed by the board. The group utilises risk management software to underpin the company's risk management process. A new risk management assurance model was implemented during the year. This annual assurance process allows the objective appraisal and degree of maturity in how the risk management system is being applied and the quality of each risk in terms of quantification and management. Resulting actions will be monitored and the results reported to the GARB.

An external assessment of the risk management process took place in 2015/16; this was sought as part of the internal investigation of the Lancashire water quality incident. This examined whether the existing risk management framework was effective in identifying and assessing risk; whether employees (as appropriate) have the necessary capabilities, knowledge and resource to use risk management processes effectively and whether the mitigation and management of risk at a strategic and tactical level were effective.

The independent review concluded that the risk management framework was robust and reflected best practice and that there was active engagement with risk management by senior management, the executive team and the board, but it could be strengthened. Following this assessment, the board took responsibility for ensuring that the recommendations were implemented including: the need for better coordination of drinking water safety plans to aid consistency; improved application by some business units of the risk management process; further embedding existing risk management processes within wholesale and improving system integration; and increasing the focus on reputational and operational risks. As reported on page 72, all actions have either been completed or were on target to be completed by their forecast completion date.

#### d. Internal controls

The committee reviews the group's internal control systems and receives updates on the findings of internal audit's investigations at every meeting, prior to reporting any significant matters to the board. Internal control systems are part of our 'business as usual' activities and are documented in the company's internal control manual which covers financial, operational and compliance controls and processes. Internal control systems are the responsibility of the CFO, with the support of the GARB, the financial control team and the internal audit team, although the head of audit and risk and his team are directly accountable to the audit committee.

Confirmation that the controls and processes are being adhered to throughout the business is the responsibility of managers, but is continually tested by the work of the internal audit team as part of its annual plan of work which the committee approves each year as well as aspects being tested by other internal assurance providers. Compliance with the internal control system is monitored annually by the completion of a self-assessment checklist by senior managers in consultation with their teams. The results are then reviewed and audited on a sample basis by the internal audit team and reported to the committee.

# Corporate governance report

## Corporate responsibility committee

With its footprint in North West England, the committee noted how the emergence of regional devolution will be of growing significance for United Utilities.

### Quick facts



- The committee comprises three directors appointed by the board, two of whom are independent non-executive directors
- The company secretary attends all meetings of the committee
- The corporate affairs director, who has responsibility for company reputation, and the business services director, who has responsibility for human resources, regularly attend meetings
- Senior operational managers attend the committee to report on the environmental and social impact of major investment programmes and projects
- The corporate responsibility committee has existed for over eight years

### Quick links

Terms of reference –

[corporate.unitedutilities.com/corporate-governance](https://corporate.unitedutilities.com/corporate-governance)

### Corporate responsibility members

-  Stephen Carter (chair)
-  Catherine Bell (stepped down as chair 22 July 2016)
-  Alison Goligher (appointed 1 August 2016)
-  Steve Mogford



Read the [Board of directors](#) on pages 52 to 54

### Dear Shareholder

In my first year as chair of the corporate responsibility committee (CRC), I am pleased to report on our work in 2016/17.

Over the past 12 months, external scrutiny of corporate behaviour has increased, particularly focused on governance, trust and legitimacy. This has been evident across many fronts – politically, as seen in the corporate governance green paper; socially where, in a post-Brexit Britain, it is perceived that companies do not fairly share rewards with society; and in the water industry itself, with Ofwat's focus on the trust and confidence that customers have in their local company.

Given this external context, the committee examined United Utilities' current corporate responsibility (CR) position. It agreed that the CR agenda was intertwined with United Utilities' strategy, supported by management's CR Panel, and that United Utilities should focus on further building legitimacy amongst the opinions of customers, regulators and government.

The committee noted the steps already taken by the company to demonstrate the value it generates, whether that is help for customers in need of extra support through its Priority Services initiative, the sharing of outperformance and tax rebates, and local projects in communities where large projects are being undertaken. It agreed to return to this topic on a regular basis.

The CRC explored what further actions the company could consider in this regard and focused in particular on customers in lower income groups i.e. those who aren't eligible for financial assistance but who are vulnerable to a financial shock. The CRC welcomed the steps being taken by the company to consider what support can be given to these customers.

The impact of the winter floods of December 2015, which devastated parts of Cumbria, Lancashire and Greater Manchester, can still be felt in the North West. In this context, the committee considered broader questions of the risks and opportunities associated with resilience and climate change and, in addition, the national issue of the unequal distribution of water. It noted the significance of these topics to PR19 planning and the importance of striking a balance between resilience and associated costs.

With its footprint in North West England, the committee noted how the emergence of regional devolution will be of growing significance for United Utilities. With the devolution of powers in areas such as strategic planning, the CRC agreed that it will be important for the company to engage with the new devolved administrations, including the Liverpool City Region and Greater Manchester Mayors, to ensure that water management challenges are understood and taken into account as regional plans are developed.



**Pictured:** Stephen Carter, chair of the corporate responsibility committee

## Main responsibilities of the committee

The board approved an unchanged set of terms of reference for the CRC in April 2017. The main duties are to:

- › consider and recommend to the board the broad corporate responsibility policy taking into account the company's desired CR positioning;
- › keep under review the group's approach to CR and ensure it is in alignment with the group strategy;
- › review CR issues and objectives material to the group's stakeholders and identify and monitor the extent to which they are reflected in group strategies, plans and policies;
- › monitor and review the status of the company's reputation and examine the contribution the group's corporate responsibility activities make towards protecting and enhancing this;
- › monitor and review compliance with the board's CR policy and scrutinise the effectiveness of the delivery of the CR policy requirements;
- › develop and recommend to the board CR targets and key performance indicators and receive and review reports on progress towards the achievement of such targets and indicators;
- › review all approved specific giving where the aggregate financial contribution exceeds £100,000 over the period of the proposed funding and to review all community giving expenditure annually; and
- › review the profile of the charitable donations directed by the United Utilities Trust Fund.

In addition, the CRC considered a wide range of topics. These included cross-cutting themes such as governance, reputational risk, stakeholder engagement and performance reporting through to specific topics such as energy, natural capital, sustainable supply chain, waste targets, the living wage, gender pay reporting and the company's approach to early careers and developing young people.

More broadly, the committee reviewed the company's responsible business scorecard, used to track progress against company objectives to provide the best service to customers, at the lowest sustainable cost, in a responsible manner. We were delighted to retain World Class status in the Dow Jones Sustainability Index for the ninth consecutive year and over 67 per cent of the stretching targets tracked by the committee to measure the company's CR performance were achieved.

Given the sustained level of external scrutiny of responsible business behaviour, and the specific challenges within the water sector, the CRC agreed it should increase the frequency of its meetings and by 2018 the committee will meet four times each year. Our areas of focus will remain largely unchanged so, as the development of plans for AMP7 gathers pace, this extra time will allow committee members more opportunity to examine the steps being taken by the company to act responsibly and ensure long-term success for both our customers and shareholders.

### **Stephen Carter**

Chair of the corporate responsibility committee

# Corporate governance report

## Corporate responsibility committee

### What has been on the committee's agenda during the year

In carrying out its duties, in the past 12 months the CRC has paid particular attention to the following:

#### Environmental

- › energy – the committee discussed the company's energy approach given the UK's energy 'trilemma' – balancing supply security, cost and low carbon – and plans to ensure United Utilities has a secure power supply to meet its needs, at the lowest cost, whilst reducing its carbon impact. The CRC noted good progress by the company in generating more energy from its own renewable sources, reducing carbon emissions and recognised the challenges in reducing energy consumption given stringent water quality and environmental standards typically mean more energy intensive processes. It also noted the role that organisational culture will play, especially in striking a balance between compliance and efficiency;
- › resilience and climate change – examining the company's approach to resilience and climate change following the 2015 winter floods, the CRC noted the significance of this topic to PR19 planning and work already underway to inform this, in the context of the national water agenda, and the potential for a common view to emerge across the sector, balancing resilience with the associated costs;
- › natural capital – growing external stakeholder interest in the emerging concept of natural capital was noted by the committee, who supported the company's intention to pilot approaches to understand its value and application;
- › waste – the CRC approved United Utilities' waste strategy target to divert 95 per cent of waste to beneficial use by 2020 and that this should be reported externally. Based on an analysis of waste types and volumes, the committee supported the company's plan to enhance its focus on construction waste;
- › sustainable supply chain – the committee considered the company's updated approach to engaging with suppliers on responsible business issues and reviewed its proposed Sustainable Supply Chain Charter. It supported company objectives to 2020 and how suppliers would be monitored as part of United Utilities' supplier relationship management processes;

#### Social

- › reward – the CRC examined two reward topics: living wage and gender pay reporting. It supported the approach taken by the company to engage proactively with the Living Wage Foundation, recognising that the main challenge is in the supply chain rather than United Utilities' employees. Given the emphasis placed on gender pay by the Prime Minister, the committee was updated on the new regulations from Autumn 2016 requiring employers to publish details of their gender pay gap with accompanying contextual narrative;
- › lower income groups – the committee explored the company's approach to those customers in lower income groups who manage to pay their bills but are vulnerable to financial shocks. It noted work underway to differentiate and segment our tariff base and the potential to target support from insights gained from new data analysis into the relationship between macroeconomic trends in the North West and individual customers' economic experience;

- › early careers – the company's approach to developing young people was discussed including the apprentice and graduate programmes, initiatives targeted at young people not in education, employment and training, and partnerships with organisations such as Teach First. The CRC noted future priorities for significant progress for BAME employees to bring more diversity into the company's talent pipeline and, in addition, clear plans for older workers;

#### Governance (including reputation)

- › reputation – this broad topic has been subject to considerable discussion by the CRC covering: an analysis of the current external landscape and growing scrutiny by government and society of responsible business behaviour; building trust and confidence as a company in the water sector; a review of United Utilities' key reputational risks; and exploring the opportunities created by regional devolution ;
- › committee meetings – the committee and the board agreed to increase the frequency of CRC meetings, from two each year to four by 2018, in recognition of the continued and growing external interest and scrutiny of responsible business behaviour;
- › ESG awareness – the CRC discussed board awareness of environmental, social and governance (ESG) matters and the emerging external interest in the level of board understanding of the subject. It requested further work be undertaken to understand how this particular area of governance would develop over the coming years; and
- › measuring and reporting CR performance – the committee reviewed the company's CR scorecard for 2015/16, noting that 67 per cent of the targets were achieved.

Looking to the next year, critically important for PR19, the CRC will:

- › continue its focus on the interaction between CR, communications and reputation, with particular emphasis on stakeholder engagement linked to the price review process;
- › return to specific topics such as the company's approach to lower income groups and payment assistance schemes and gender pay reporting;
- › consider issues such as: what Brexit means for environmental and social legislation; the responsible business issues and opportunities afforded by the price review process; and a look at the new competitive water market for non-retail customers through a CR lens;
- › review CR strategies including natural environment and community investment;
- › consider other matters such as integrated reporting in the 2017/18 Annual Report; and
- › review progress in delivering responsible business targets set out to 2020.



# Corporate governance report

## Annual statement from the remuneration committee chair

We are confident that the review we have undertaken will continue to encourage a keen focus on the sustainable delivery of superior financial and operational performance which will, in turn, support the long-term success of the company.

### Quick facts



- The Code requires that ‘the board should establish a remuneration committee of at least three independent non-executive directors’
- The role of the committee is to set remuneration terms for all executive directors, other senior executives and the Chairman
- By invitation of the committee, meetings are also attended by the Chairman, the CEO, the company secretary, the business services director, the head of reward and pensions and the external advisor to the committee

### Quick links

Terms of reference –  
[corporate.unitedutilities.com/corporate-governance](http://corporate.unitedutilities.com/corporate-governance)

### Dear Shareholder

I am pleased to introduce the directors’ remuneration report for the year ended 31 March 2017, which includes my statement, an ‘at a glance’ summary, a revised directors’ remuneration policy which is intended to take effect from the date of our 2017 AGM (subject to shareholder approval) and the annual report on remuneration for the year ended 31 March 2017.

### Remuneration review

During the year the committee undertook a review of executive pay arrangements, in advance of seeking shareholder approval for a new directors’ remuneration policy at the 2017 AGM. The purpose of the review was to ensure that executive pay remains aligned with business strategy, reflects best practice expectations of shareholders and is appropriately positioned relative to the market. In developing the policy, we consulted with major shareholders and investor groups during November and December 2016. The consultation process was constructive and there was, in general, support for our proposals. The responses received were carefully considered, and played an important role in informing the review process.

Following this review, no significant changes are proposed to the current arrangements as feedback indicates these are working well. A few minor revisions to the policy are proposed as follows:

- › to include the flexibility to adjust the balance of incentives in the reward package towards the longer term;
- › to increase flexibility on how long-term performance metrics are weighted to enable appropriate measurement of performance over the life of the policy; and
- › to strengthen recovery/withholding provisions.

See pages 91 to 97 for further detail on these proposed amendments.

### Implementation of directors’ remuneration policy

#### Salary increases

Executive directors received a base salary increase of 2 per cent with effect from 1 September 2016, in line with the headline increase applied across the wider workforce. Salaries will next be reviewed in September 2017 in line with our normal annual review process.

#### Annual bonus

The annual bonus measures incentivise and reward delivery of our business strategy and annual plan, and reflect the importance and challenge of regulatory commitments for the period 2015-20. These bonus measures apply not only to the executive directors, but also to managers and employees throughout the company, to ensure alignment to the business plan at all levels.

### Index

- Read more about [At a glance summary: executive directors’ remuneration](#) on pages 88 to 90
- Read more about [Directors’ remuneration policy](#) on pages 91 to 97
- Read more about [Annual report on remuneration](#) on pages 98 to 109

### Remuneration committee members

- Sara Weller (chair)
- Dr Catherine Bell (stepped down 22 July 2016)
- Mark Clare
- Alison Goligher (appointed 1 August 2016)
- Brian May (appointed 16 May 2017)



**Pictured:** Sara Weller, chair of the remuneration committee

As set out in detail in the annual report on remuneration, we have seen another strong year of performance in 2016/17 with progress made in moving towards our vision of becoming the UK's best water and wastewater company, providing great service to customers. Underlying operating profit was up by £19 million and customer service continues to improve with the achievement of our best ever score under Ofwat's revised qualitative SIM score for this regulatory period. The efficient and effective delivery of our capital programme is reflected in our Time, Cost and Quality index (TCQI) score which remains high at 92.9 per cent and our accelerated capital expenditure has helped us to optimise performance against our outcome delivery incentives. Our strong corporate responsibility and environmental credentials were recognised again this year when we retained a World Class ranking in the Dow Jones Sustainability Index for the ninth consecutive year.

During the year, the committee used our discretion to exclude any profit or loss arising from non-household services in the underlying operating profit figure used for setting the bonus targets and assessing the outcome. This was to recognise changes in the scope of business operations from the creation of a joint venture with Severn Trent in June 2016 to provide non-household services (Water Plus).

Overall company results, together with strong personal performance by the two executive directors, has resulted in annual bonus outturn of around 84 per cent of maximum (up from the 2015/16 outcome of around 54 per cent of maximum) and a company-wide bonus pool totalling £18 million (up from £13 million in the prior year). Half of the executive directors' annual bonuses will be deferred into shares for a period of three years.

In 2017/18, the annual bonus will operate in a broadly similar way with the exception that the Dow Jones measure (currently representing a maximum of four per cent of executive directors' bonuses) will be removed from the bonus scorecard and the weighting redistributed to the outcome delivery incentive (ODI) measure. The ODI targets, introduced in 2015, cover a broad range of customer priorities which closely link to the sustainable delivery of company performance, such as water quality, reliability of supply and wastewater network performance. The ODI targets also have a direct financial impact on shareholder value, and so on a going forward basis will, in the committee's view, form a stronger measure of performance for customers and shareholders than the Dow Jones measure.

In addition, in line with the revised policy, recovery and withholding provisions for the annual bonus scheme will be made more robust on an ongoing basis.

### Long-term incentives

The Long Term Plan awards which were granted in 2014, and whose performance is measured over the three years to 31 March 2017, are expected to vest at 59.1 per cent. This reflects strong total shareholder return over the period of around 45 per cent and the achievement of the threshold level of sustainable dividend performance. The customer service excellence measure is expected to outturn between median and upper quartile versus comparator water companies. The awards for executive directors will vest following an additional two-year holding period.

Long Term Plan awards to be granted in 2017 will operate in a broadly consistent way, with the exception that, in line with the revised policy, recovery and withholding provisions will be made more robust on an ongoing basis and some changes will be made to the customer service measure to ensure we are measuring performance appropriately. For further details see page 102.

### Agenda for 2017/18

The main focus of the committee's work over the past year has been on a thorough review of the remuneration policy, taking account of changes to best practice in the wider market and the related shareholder consultation process. We are confident that the review we have undertaken will continue to encourage a keen focus on the sustainable delivery of superior financial and operational performance which will, in turn, support the long-term success of the company. During 2017/18, we will continue to keep the remuneration arrangements under review, although no material changes in how our policy is implemented are expected. We remain mindful of the developing remuneration landscape and a key priority for 2017/18 will be to continue to monitor the executive pay environment, governance developments and market practice.

I hope we will receive your support for the resolutions relating to remuneration at the 2017 AGM.

**Sara Weller**  
Chair of the remuneration committee

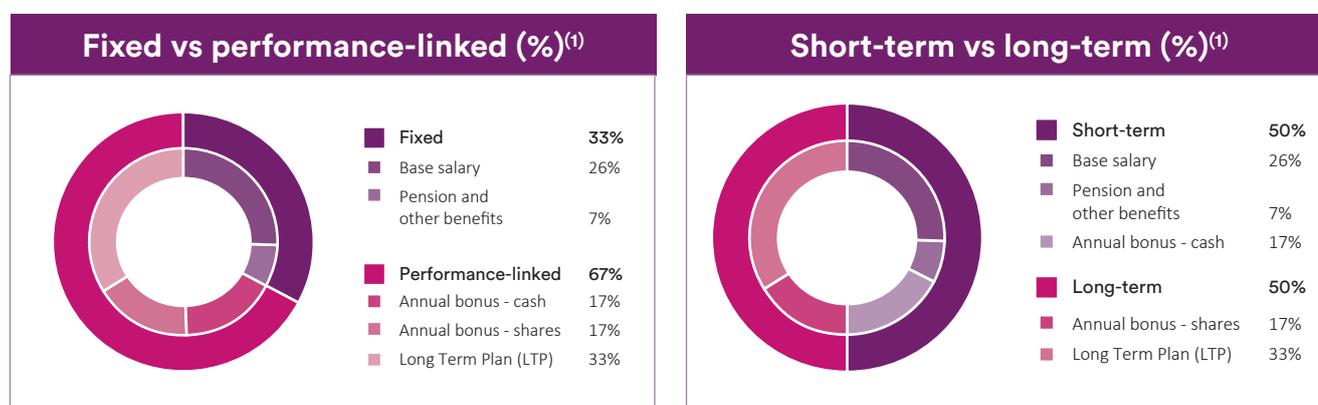
# Corporate governance report

## At a glance summary: executive directors' remuneration

### Executive directors' remuneration policy

#### Elements of executive directors' pay

A significant proportion of executive directors' pay is performance-linked, long-term and remains 'at risk' (i.e. subject to withholding and recovery provisions for a period over which the committee can withhold vesting or recover sums paid):



(1) Based on maximum payout scenario for executive directors assuming the normal maximum award level of 130 per cent of salary for the Long Term Plan (LTP).

### Pay at risk



Further details on what triggers withholding and recovery provisions can be found on pages 92 to 93.

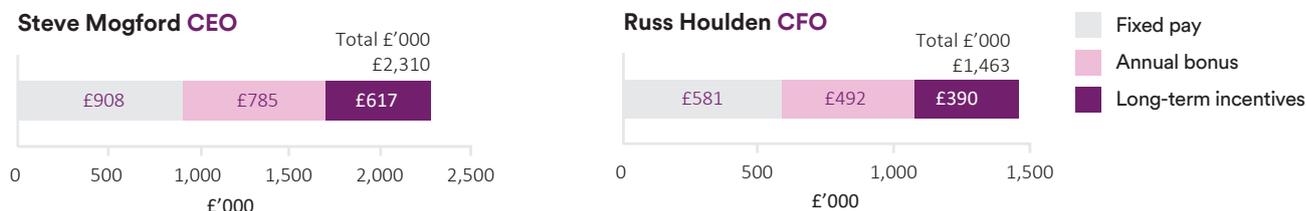
### Implementation of directors' remuneration policy in 2016/17

The table below summarises the implementation of the directors' remuneration policy for executive directors in 2016/17. For further details see the annual report on remuneration on pages 98 to 109.

Key element	Implementation of policy in 2016/17
<b>Base salary</b>	— Salary increase of 2.0 per cent from 1 September 2016 in line with the headline increase for the wider workforce
<b>Benefits and pension</b>	— Market competitive benefits package — Cash pension allowance of 22 per cent of base salary
<b>Annual bonus</b>	— Maximum opportunity of 130 per cent of base salary — 2016/17 annual bonus outcome of around 84 per cent of maximum — 50 per cent of 2016/17 annual bonus deferred in shares for three years — Withholding and recovery provisions apply
<b>Long Term Plan</b>	— Award of 130 per cent of base salary — Estimated long-term incentive vesting of 59.1 per cent for the performance period 1 April 2014 to 31 March 2017, supported by a total shareholder return of around 45 per cent over the same period. These awards will vest after an additional two-year holding period — Withholding and recovery provisions apply
<b>Shareholding guidelines</b>	— Personal shareholdings remain significantly above the 200 per cent of salary minimum guideline

### Single total figure of remuneration for executive directors for 2016/17

Fixed pay comprises base salary, benefits and pension. Further information on the single total figure of remuneration can be seen on page 98.



### KPI performance

Annual bonus – Year ended 31 March 2017						Long Term Plan – Three years ended 31 March 2017	
Underlying operating profit <sup>1</sup>	SIM qualitative <sup>2</sup>	SIM quantitative <sup>2</sup>	Wholesale outcome delivery incentive (ODI) composite	Time, Cost and Quality index (TCQI)	Dow Jones sustainability index	Total shareholder return (TSR) <sup>3</sup>	Underlying dividend cover <sup>4</sup>
●	●	●	●	●	●	●	●
<b>£622.9m</b>	<b>4.42</b>	<b>77</b>	<b>£6.7m</b>	<b>92.9%</b>	<b>100%</b>	<b>44%</b>	<b>1.27</b>

**Key:**

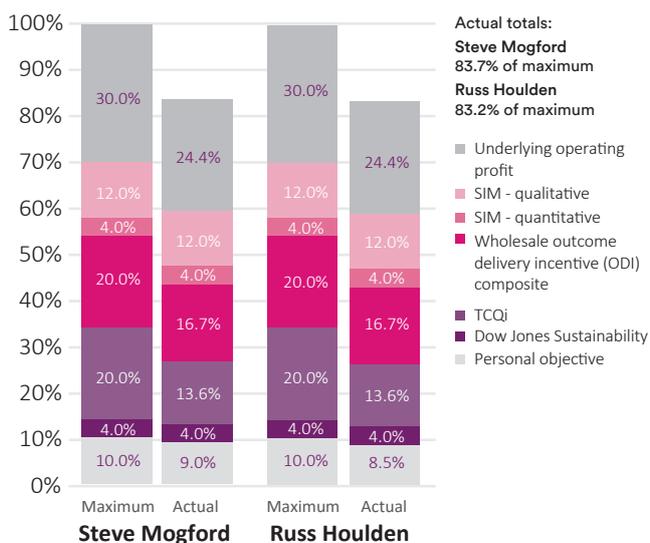
● Above stretch target ● Between threshold and stretch targets ● Below threshold target

- (1) For the purpose of annual bonus underlying operating profit is subject to a number of adjustments, principally in regard to infrastructure renewals expenditure, giving an underlying operating profit of £765.4 million. See page 99 for further details.
- (2) The estimated ranking versus 17 other water companies using the SIM combined score is seventh.
- (3) For the purpose of the Long Term Plan, the TSR index is averaged over the three months prior to the start and end of the performance period.
- (4) Average underlying dividend cover over 2014/15, 2015/16 and 2016/17.

### Annual bonus and Long Term Plan (LTP) outcomes

The charts below show the results of the performance against targets for the annual bonus and LTP schemes. Further information on annual bonus can be seen on page 99 and on LTP on page 101.

#### 2016/17 Annual bonus outcome



#### Estimated 2014 Long Term Plan (LTP) outcome



# Corporate governance report

## At a glance summary: executive directors' remuneration

### Aligning remuneration to business strategy

Our remuneration policy has been designed in order to promote the long-term success of the company.

The following table provides a summary of how our incentive framework aligns with our business strategy and the results that it delivers. Many of the performance measures are key performance indicators (KPIs) for the regulatory period 2015-20 (see pages 31 to 33).

Alignment to strategy		Link to strategic objectives	A long-term approach to creating sustainable value
<b>Annual bonus</b>			
Underlying operating profit	Key measure of shareholder value.		✓
Customer service in year › Service incentive mechanism – qualitative › Service incentive mechanism – quantitative	Delivering the best service to customers is a strategic objective. Ofwat can apply financial incentives or penalties depending on our customer service performance.		✓
Maintaining and enhancing services for customers › Wholesale outcome delivery incentive (ODI) composite › Time, cost and quality of the capital programme (TCQi)	Delivering the best service to customers is a strategic objective. There is a direct financial impact on the company of Ofwat incentives and penalties for delivery/non-delivery of customer promises. Keeping tight control of our capital programmes ensures we can provide a reliable service to our customers at the lowest sustainable cost.	  	✓
Corporate responsibility › Dow Jones Sustainability Index <sup>1</sup>	Ensures that we manage our business in a responsible manner.		✓
Personal	Focused on specific areas of individual contribution.	  	✓
Compulsory deferral of bonus	Deferral of part of bonus into shares aligns the interests of executive directors and shareholders.		✓
<b>Long Term Plan (LTP)</b>			
Relative total shareholder return (TSR)	Direct measure of delivery of shareholder returns, rewarding management for the outperformance of a comparator group of companies.		✓
Sustainable dividends	Direct measure of return to shareholders through dividend payments, whilst focusing on the creation of strong earnings that ensure the sustainability of dividends.	 	✓
Customer service excellence	This is fundamental to delivering our vision of becoming the best UK water and wastewater company, providing great service to our customers. This measure has a direct financial impact on the company as Ofwat can apply financial incentives or penalties depending on our customer service performance.	 	✓
Additional two-year holding period	Ensures continued alignment with shareholder interests and provides an additional period over which withholding can be applied.		✓
Shareholding guidelines	It is important that a significant investment is made by each executive director in the shares of the company to provide alignment with shareholder interests.		✓

#### Key:

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

(1) The Dow Jones Sustainability Index is included as a measure for the 2016/17 annual bonus but will be removed for the 2017/18 annual bonus. See page 100 for further details.

# Corporate governance report

## Directors' remuneration policy

This part of the directors' remuneration report sets out the remuneration policy for the company and has been prepared in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The policy in this report will be put to a binding shareholder vote at the 2017 AGM on 28 July 2017 and will take formal effect from that date, subject to shareholder approval. It is intended that the policy will formally apply for the three years beginning on the date of approval.

### Overview of remuneration policy

The company's remuneration arrangements are designed to promote the long-term success of the company. The company does not pay more than is necessary for this purpose. The committee recognises that the company operates in the North West of England in a regulated environment and therefore needs to ensure that the structure of executive remuneration reflects both the practices of the markets in which its executives operate, and stakeholder expectations of how the company should be run.

The committee monitors the remuneration arrangements to ensure that there is an appropriate balance between risk and reward and that the long-term performance of the business is not compromised by the pursuit of short-term value. There is a strong direct link between incentives and the company's strategy and if the strategy is delivered within an acceptable level of risk, senior executives will be rewarded through the annual bonus and long-term incentives. If it is not delivered, then a significant part of their potential remuneration will not be paid.

### Considerations when determining remuneration policy

The committee understands that listening to the views of the company's key stakeholders plays a vital role in formulating and implementing a successful remuneration policy over the long term. The committee thus actively seeks the views of shareholders and other key stakeholders to inform the development of the remuneration policy, particularly where any changes to policy are envisaged. Although employees are not consulted directly on executive remuneration policy, employee engagement surveys are carried out annually and regular discussion takes place with union representatives on matters of pay and remuneration for employees covered by collective bargaining or consultation arrangements. The committee takes into account the general base salary increase and remuneration arrangements for the wider employee population when determining remuneration policy for the executive directors.

### Changes to the remuneration policy

As described in the annual statement from the remuneration committee chair, during the year the committee undertook a review of the current executive directors' remuneration policy to ensure that it remains aligned with business strategy, reflects best practice expectations of investors and is appropriately positioned relative to the market. In doing so, the committee engaged with institutional shareholders as well as the leading shareholder advisory organisations. The changes proposed are minor and relate principally to the introduction of further flexibility in the policy and the strengthening of recovery/withholding provisions. In summary, the key proposed changes include:

- › increasing the maximum award limit under the Long Term Plan to 200 per cent of salary. However, the normal maximum remains unchanged at 130 per cent of salary for 2017 and any increase to this over the term of this policy for current executive directors will be subject to consultation with major shareholders;
- › additional flexibility in the weightings and measures for the Long Term Plan;
- › strengthening of the withholding and recovery provisions in the annual bonus and Long Term Plan; and
- › limiting the notice period the company must give to executive directors when terminating their employment to a maximum of 12 months in any circumstances.

### Future policy table for directors

Base salary	
<b>Purpose and link to strategy:</b> To attract and retain executives of the experience and quality required to deliver the company's strategy.	
Operation	Maximum opportunity
<p>Normally reviewed annually, typically effective 1 September.</p> <p>Significant increases in salary should only take place infrequently, for example where there has been a material increase in:</p> <ul style="list-style-type: none"> <li>— the size of the individual's role;</li> <li>— the size of the company (through mergers and acquisitions); or</li> <li>— the pay market for directly comparable companies (for example, companies of a similar size and complexity).</li> </ul> <p>On recruitment or promotion to executive director, the committee will take into account previous remuneration, and pay levels for comparable companies, when setting salary levels. This may lead to salary being set at a lower or higher level than for the previous incumbent.</p>	<p>Current salary levels are shown in the annual report on remuneration.</p> <p>Executive directors will normally receive a salary increase broadly in line with the increase awarded to the general workforce, unless one or more of the conditions outlined under 'operation' is met.</p> <p>Where the committee has set the salary of a new hire at a discount to the market level initially, a series of planned increases can be implemented over the following few years to bring the salary to the appropriate market position, subject to individual performance.</p>
	Performance measures
	None.

# Corporate governance report

## Directors' remuneration policy

Benefits	
<p><b>Purpose and link to strategy:</b> To provide market competitive benefits to help recruit and retain high calibre executives.</p>	
Operation	Maximum opportunity
<p>Provision of benefits such as:</p> <ul style="list-style-type: none"> <li>— health benefits;</li> <li>— car or car allowance;</li> <li>— relocation assistance;</li> <li>— life assurance;</li> <li>— group income protection;</li> <li>— all employee share schemes (e.g. opportunity to join the ShareBuy scheme);</li> <li>— travel; and</li> <li>— communication costs.</li> </ul> <p>Any reasonable business related expenses can be reimbursed (and any tax thereon met if determined to be a taxable benefit).</p> <p>Executives will be eligible for any other benefits which are introduced for the wider workforce on broadly similar terms and additional benefits might be provided from time to time if the committee decides payment of such benefits is appropriate and in line with emerging market practice.</p>	<p>As it is not possible to calculate in advance the cost of all benefits, a maximum is not pre-determined.</p> <hr/> <p><b>Performance measures</b></p> <p>None.</p>
Pension	
<p><b>Purpose and link to strategy:</b> To provide a broadly mid-market level of retirement benefits.</p>	
Operation	Maximum opportunity
<p>Executive directors are offered the choice of:</p> <ul style="list-style-type: none"> <li>— a company contribution into a defined contribution pension scheme;</li> <li>— a cash allowance in lieu of pension; or</li> <li>— a combination of a company contribution into a defined contribution pension scheme and a cash allowance.</li> </ul> <p>External hires will not be eligible to join a defined benefit pension scheme.</p> <p>Internal promotees who are active members of an existing United Utilities defined benefit scheme will be offered the choice of staying in that scheme or of choosing one of the above options.</p>	<ul style="list-style-type: none"> <li>— up to 25 per cent of salary into a defined contribution scheme;</li> <li>— cash allowance of broadly equivalent cost to the company (up to 25 per cent of salary less employer National Insurance Contributions at the prevailing rate, i.e. up to 22 per cent of base salary for 017/18); or</li> <li>— a combination of both, such that the cost to the company is broadly the same.</li> </ul> <p>Under the defined benefit schemes, a maximum future accrual of 1/80th pension plus 3/80ths lump sum of final pensionable salary for each year of service.</p> <hr/> <p><b>Performance measures</b></p> <p>None.</p>
Annual bonus	
<p><b>Purpose and link to strategy:</b> To incentivise performance against personal objectives and selected financial and operational KPIs which are directly linked to business strategy. Deferral of part of bonus into shares aligns the interests of executive directors and shareholders.</p>	
Operation	Maximum opportunity
<p>A maximum of 50 per cent of bonus awarded paid as cash.</p> <p>A minimum of 50 per cent of bonus awarded deferred into company shares under the Deferred Bonus Plan (DBP) for a period of at least three years.</p> <p>DBP shares accrue dividend equivalents.</p> <p>Not pensionable.</p> <p>Bonuses are subject to withholding and recovery provisions in certain negative circumstances; for example, in the event of a material misstatement of audited financial results, an error in the calculation or gross misconduct.</p>	<p>Maximum award level of up to 130 per cent of salary, for the achievement of stretching performance objectives.</p> <hr/> <p><b>Performance measures</b></p> <p>Payments predominantly based on financial and operational performance, with a minority based on achievement of personal objectives.</p> <p>Targets and weightings set by reference to the company's financial and operating plans.</p> <p>Target bonus of up to 50 per cent of maximum bonus potential and bonus of up to 25 per cent of maximum for threshold performance.</p>

### Long Term Plan (LTP)

**Purpose and link to strategy:** To incentivise long-term value creation and alignment with longer term returns to shareholders.

Operation	Maximum opportunity
<p>Awards under the Long Term Plan are rights to receive company shares, subject to certain performance conditions.</p> <p>Each award is measured over at least a three-year performance period.</p> <p>An additional two-year holding period applies after the end of the three-year performance period.</p> <p>Vested shares accrue dividend equivalents.</p> <p>Shares under the LTP are subject to recovery and withholding provisions in certain negative circumstances; for example: material misstatement of audited financial results, an error in the calculation or gross misconduct.</p>	<p>The normal maximum award level will be up to 130 per cent of salary per annum.</p> <p>The overall policy limit will be 200 per cent of salary. It is not anticipated that awards above the normal level will be made to current executive directors and any such increase on an ongoing basis will be subject to prior consultation with major shareholders.</p>
	<p><b>Performance measures</b></p> <p>The current performance measures are relative total shareholder return (TSR), sustainable dividends and customer service excellence. The weighting of any one of these single measures will not exceed 40 per cent.</p> <p>Any vesting is also subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance.</p> <p>The committee retains discretion to set alternative performance measures for future awards but will consult with major shareholders before making any changes to the currently applied measures.</p> <p>100 per cent of awards vest for stretch performance, up to 25 per cent of an award vests for threshold performance and no awards vest for below threshold performance.</p>

### Non-executive directors' fees and benefits

**Purpose and link to strategy:** To attract non-executive directors with a broad range of experience and skills to oversee the development and implementation of our strategy.

Operation	Maximum opportunity
<p>The remuneration policy for the non-executive directors (with the exception of the Chairman) is set by a separate committee of the board. The policy for the Chairman is determined by the remuneration committee (of which the Chairman is not a member).</p> <p>Fees are reviewed annually, taking into account the salary increase for the general workforce and the levels of fees paid by companies of a similar size and complexity. Any changes are normally effective from 1 September.</p> <p>Additional fees are paid to the chairs of certain board sub-committees and to the senior independent non-executive director.</p> <p>In exceptional circumstances, if there is a temporary yet material increase in the time commitments for non-executive directors, the board may pay extra fees on a pro rata basis to recognise the additional workload.</p> <p>No eligibility for bonuses, long-term incentive plans, pension schemes, healthcare arrangements or employee share schemes.</p> <p>The company repays any reasonable expenses that a non-executive director incurs in carrying out their duties as a director, including travel, hospitality-related and other modest benefits and any tax liabilities thereon, if appropriate.</p>	<p>Current fee levels are shown in the annual report on remuneration.</p> <p>The value of benefits may vary from year to year according to the cost to the company.</p>
	<p><b>Performance measures</b></p> <p>Non-executive directors are not eligible to participate in any performance-related arrangements.</p>

# Corporate governance report

## Directors' remuneration policy

### Notes to the policy table

#### Selection of performance measures and targets

Performance measures for the annual bonus are selected annually to align with the company's key strategic goals for the year and reflect financial, operational and personal objectives. 'Target' performance is typically set in line with the business plan for the year, following rigorous debate and approval of the plan by the board. Threshold to stretch targets are then set based on a sliding scale on the basis of relevant commercial factors. Only modest rewards are available for delivering threshold performance levels, with rewards at stretch requiring substantial outperformance of the business plan. Details of the measures used for the annual bonus are given in the annual report on remuneration.

The current Long Term Plan (LTP) measures were selected by the committee following an extensive review and shareholder consultation in 2012/13. These measures were reviewed again as part of the wider review of the remuneration policy in 2016/17 and are considered to continue to align with the company's key strategic goals and be closely linked to the creation of long-term shareholder value as follows:

Measure	Why selected
Relative total shareholder return	Direct measure of delivery of shareholder returns, rewarding management for outperformance of a comparator group of companies.
Sustainable dividends	Direct measure of return to shareholders through dividend payments, whilst focusing on the creation of strong earnings that ensure the sustainability of dividends.
Customer service excellence	It is a key strategic objective to provide the best service to customers. This is fundamental to delivering our vision of being the best UK water and wastewater company, providing great service to our customers. This measure has a direct financial impact on the company as our regulator can apply financial incentives or penalties depending on our customer service performance.

The policy provides for committee discretion to alter the LTP measures and weightings to ensure they continue to facilitate an appropriate measurement of performance over the life of the policy (taking into account any evolution of the strategic goals of the company). LTP targets are set taking into account a number of factors, including reference to market practice, the company business plan and analysts' forecasts where relevant. The LTP will only vest in full if stretching business performance is achieved.

#### Annual bonus and long-term incentives – flexibility, discretion and judgement

The committee will operate the company's incentive plans according to their respective rules and consistent with normal market practice, the Listing Rules and HMRC rules where relevant, including flexibility in a number of regards. These include making awards and setting performance criteria each year, dealing with leavers, and adjustments to awards and performance criteria following acquisitions, disposals, changes in share capital and to take account of the impact of other merger and acquisition activity. The committee also retains discretion within the policy to adjust the targets, set different measures and/or alter weightings for the annual bonus plan, pay dividend equivalents on vested shares up to the date those shares can first reasonably be exercised and, in exceptional circumstances, under the rules of the long-term incentive plans to adjust targets to ensure that the awards fulfil their original purposes (for example, if an external benchmark or measure is no longer available). All assessments of performance are ultimately subject to the committee's judgement.

Any discretion exercised (and the rationale) will be disclosed in the annual remuneration report.

#### Historic awards

All historic awards that were granted under any current or previous share schemes operated by the company and remain outstanding, remain eligible to vest based on their original award terms.

#### Differences in policy for executive directors compared to other employees

The remuneration approach is consistently applied at levels below the executive directors. Key features include:

- › market competitive levels of remuneration, incentives and benefits to attract and retain employees;
- › employees at all levels participate in a bonus scheme with the same corporate performance measures as for executive directors; and
- › all employees have the opportunity to participate in the HMRC approved share incentive plan, ShareBuy.

At senior levels, remuneration is increasingly long-term, and 'at risk' with an increased emphasis on performance related pay and share-based remuneration.

## Scenarios for total remuneration

The charts below show the pay-out under the remuneration policy for each executive director under three different scenarios.

### Steve Mogford CEO

£'000s



### Russ Houlden CFO

£'000s



Notes on the scenario methodology:

- › fixed pay is base salary effective 1 September 2016 plus cash allowance in lieu of pension of 22 per cent of salary and the value of benefits as shown in the single total figure of remuneration table for 2016/17;
- › target performance is the level of performance required for the bonus and Long Term Plan to pay out at 50 per cent of maximum;
- › maximum performance would result in 100 per cent vesting of the bonus and Long Term Plan (i.e. 260 per cent of salary in total);
- › annual bonus includes amounts compulsorily deferred into shares;
- › Long Term Plan is measured at face value, i.e. no assumption for dividends or changes in share price; and
- › amounts relating to all-employee share schemes have, for simplicity, been excluded from the charts.

## Shareholding guidelines

The committee believes that it is important for a significant investment to be made by each executive director in the shares of the company to provide alignment with shareholder interests. Shareholding guidelines are therefore operated and the details of how these are currently applied are provided in the annual report on remuneration.

## External directorships

The company recognises that its executive directors may be invited to become non-executive directors of other companies outside the company and exposure to such non-executive duties can broaden experience and knowledge, which would be of benefit to the company. Any external appointments are subject to board approval (which would not be given if the proposed appointment was with a competing company, would lead to a material conflict of interest or could have a detrimental effect on a director's performance). Directors will be allowed to retain any fees received in respect of such appointments.

# Corporate governance report

## Directors' remuneration policy

### Service contracts and letters of appointment

Executive directors' service contracts are subject to up to one year's notice period when terminated by the company and at least six months' notice when terminated by the director.

The policy on payments for loss of office is set out in the next section.

The Chairman and other non-executive directors have letters of appointment rather than service contracts. Their appointments may be terminated without compensation at any time. All non-executive directors are subject to re-election at the AGM.

Copies of executive directors' service contracts and non-executive directors' letters of appointment are available for inspection at the company's registered office during normal hours of business and will be available at the company's AGM. Copies of non-executive directors' letters of appointment can also be viewed on the company's website.

### Approach to recruitment remuneration

The remuneration package for a new executive director would be set in accordance with the terms of the company's approved remuneration policy in force at the time of appointment.

#### Buy-out awards

In addition, the committee may offer additional cash and/or share-based elements (on a one-time basis or ongoing) when it considers these to be in the best interests of the company (and therefore shareholders). Any such payments would be limited to a reasonable estimate of value of remuneration lost when leaving the former employer and would reflect the delivery mechanism (i.e. cash and/or share-based), time horizons and whether performance requirements are attached to that remuneration. Shareholders will be informed of any such payments at the time of appointment.

#### Maximum level of variable pay

The maximum level of long-term incentives which may be awarded to a new executive director will be limited to the maximum Long Term Plan limit of 200 per cent of salary per annum on an ongoing basis. Therefore, the maximum level of overall variable pay that may be offered will be 330 per cent of salary (i.e. 130 per cent annual bonus plus 200 per cent Long Term Plan) per annum on an ongoing basis. These limits are in addition to the value of any buy-out arrangements which are governed by the policy above.

In the case of an internal appointment, any variable pay element awarded in respect of the prior role would be allowed to pay out according to its terms, adjusted as relevant to take into account the appointment. In addition, any other previously awarded entitlements would continue, and be disclosed in the next annual report on remuneration.

#### Base salary and relocation expenses

Base salary levels for new recruits will be set in accordance with the policy, taking into account the experience of the individual recruited. The committee has the flexibility to set the salary of a new appointment at a discount to the market level initially, with a series of planned increases implemented over the following years to bring the salary to the appropriate market position, subject to individual performance in the role.

For external and internal appointments, the committee may agree that the company will meet certain relocation and/or incidental expenses as appropriate.

#### Annual bonus performance conditions

Where a new executive director is appointed part way through a financial year, the committee may set different annual bonus measures and targets for the new executive director from those used for other executive directors (for the initial year only).

#### Appointment of non-executive directors

For the appointment of a new Chairman or non-executive director, the fee arrangement would be set in accordance with the approved remuneration policy in force at that time. Non-executive directors' fees are set by a separate committee of the board; the Chairman's fees are set by the remuneration committee.

## Payment for loss of office

The circumstances of the termination, including the individual's performance and an individual's duty and opportunity to mitigate losses are taken into account in every case. Our policy is to stop or reduce compensatory payments to former executive directors to the extent that they receive remuneration from other employment during the compensation period. A robust line on reducing compensation is applied and payments to departing employees may be phased in order to mitigate loss. Our policy is shown in the table below:

Provision	Summary terms
<b>Compensation for loss of office</b>	<ul style="list-style-type: none"> <li>— An executive director's service contract may be terminated without notice and without any further payment or compensation, except for sums earned up to the date of termination, on the occurrence of certain contractually specified events such as gross misconduct.</li> <li>— No termination payment if full notice is worked.</li> <li>— Otherwise, a payment in respect of the period of notice not worked of basic salary, plus pension and car allowance for that period.</li> <li>— Half of the termination payment will be paid within 14 days of date of termination.</li> <li>— The other half will be paid in monthly instalments over what would have been the second half of the notice period. This will be reduced by the value of any salary, pension contribution and car allowance earned in new paid employment in that period.</li> </ul>
<b>Treatment of annual bonus on termination</b>	<ul style="list-style-type: none"> <li>— A time prorated bonus may be payable for the period of active service; however, there is no automatic entitlement to payments under the bonus scheme. Any payment is at the discretion of the committee and is subject to recovery and withholding provisions as detailed in the policy table.</li> <li>— Performance targets would apply in all circumstances.</li> </ul>
<b>Treatment of deferred bonus on termination</b>	<ul style="list-style-type: none"> <li>— Determined on the basis of the relevant plan rules. Full details can be found on the company's website.</li> <li>— Deferred bonuses are subject to recovery and withholding provisions as detailed in the policy table.</li> <li>— The default treatment is that any outstanding awards will vest in full on the normal vesting date with no time prorating applying.</li> <li>— On a change of control, awards will generally vest on the date of a change of control, unless the committee permits (or requires) awards to roll over into equivalent shares in the acquirer.</li> </ul>
<b>Treatment of unvested long-term incentives on termination</b>	<ul style="list-style-type: none"> <li>— Determined on the basis of the relevant plan rules. Full details can be found on the company's website.</li> <li>— Normally, any outstanding awards will lapse on date of cessation of employment (if that occurs during the performance period).</li> <li>— However, under the rules of the plans, in certain prescribed circumstances, such as death, disability, mutually agreed retirement or other circumstances at the discretion of the committee, 'good leaver' status can be applied. In these circumstances, a participant's awards vest on a time prorated basis subject to the satisfaction of relevant performance criteria, with the balance of awards lapsing. The committee retains the discretion not to time prorate if it is inappropriate to do so in particular circumstances. The committee will take into account the individual's performance and the reasons for their departure when determining whether 'good leaver' status can be applied.</li> <li>— On a change of control, awards will generally vest on the date of a change of control taking in to account the extent to which any performance condition has been satisfied at that point. Time prorating will normally apply unless the committee determines otherwise.</li> </ul>
<b>Treatment of pensions on termination</b>	<ul style="list-style-type: none"> <li>— On redundancy, an augmentation may apply to active members of a United Utilities defined benefit pension scheme in line with the trust deed and rules of the appropriate section.</li> </ul>

Outplacement services, reimbursement of legal costs and any other incidental expenses may be provided where appropriate. Any statutory entitlements or compromise claims in connection with a termination of employment would be paid as necessary. Outstanding savings/shares under all-employee share plans would be transferred in accordance with the terms of the plans as approved by HMRC.

# Corporate governance report

## Annual report on remuneration

### Executive directors' remuneration for the year ended 31 March 2017

Single total figure of remuneration for executive directors (audited information)

Year ended 31 March	Fixed pay						Variable pay				Total £'000	
	Base salary £'000		Pension £'000		Benefits £'000		Annual bonus £'000		Long-term incentives £'000			
	2017	2016	2017	2016	2017	2016	2017	2016	2017 <sup>(1)</sup>	2016 <sup>(2)</sup>	2017	2016
Steve Mogford	721	707	159	156	28	26	785	501	617	1,468	2,310	2,858
Russ Houlden	455	446	100	98	26	23	492	313	390	705	1,463	1,585

(1) The long-term incentive amount is in respect of the Long Term Plan award which was granted in July 2014 (and which will vest based on performance over the three-year period 1 April 2014 to 31 March 2017). The Long Term Plan amount is estimated as the vesting percentage for the one-third relating to customer service excellence will not be known until later in 2017, and the award will not vest until the end of an additional two-year holding period. See page 101 for further detail.

(2) The long-term incentive amount for the year ended 31 March 2016 is in respect of the Long Term Plan award which was granted in July 2013 and the executive directors' one-off Matched Share Investment Scheme awards which were granted as part of their terms of appointment and vested during the year. The long-term incentive amount has been restated in respect of the 2013 Long Term Plan whose performance period ended on 31 March 2016, but which will not vest until the end of an additional two-year holding period. The final vesting outcome was confirmed by the committee in July 2016 as 33.6 per cent. The restated amount reflects the additional dividend equivalents accruing on these awards and is based on the average share price over the three-month period 1 January 2017 to 31 March 2017 of 945.6 pence per share.

#### Base salary

Executive director salaries were increased by 2.0 per cent with effect from 1 September 2016, in line with the headline increase applied across the wider workforce. The committee judged that the increase was supported by very good individual and business performance.

Executive director	Base salary £'000	
	1 Sept 2016	1 Sept 2015
Steve Mogford	727.0	713.0
Russ Houlden	459.0	450.0

#### Pensions

The executive directors receive a cash allowance of 22 per cent of base salary in lieu of pension. No changes are expected to the pensions cash allowance percentage during the year commencing 1 April 2017.

#### Benefits

For executive directors, benefits include a car allowance of £14,000; health, life and income protection insurance; travel costs; and communication costs.

No changes are expected to benefits during the year commencing 1 April 2017 (see page 92 in the policy report).

## Annual bonus

### Annual bonus in respect of financial year ended 31 March 2017 (audited information)

The performance measures, targets and outcomes in respect of the executive directors' annual bonus for the year ended 31 March 2017 are set out below. The table on page 90 summarises how these performance measures are linked to our business strategy.

Measure	Achieved			Payout as a % of maximum	Steve Mogford weighting (% of award) <b>Outcome</b>	Russ Houlden weighting (% of award) <b>Outcome</b>
	Threshold (25% vesting)	Target	Stretch (100% vesting)			
<b>Underlying operating profit<sup>(1)</sup></b>	£724.6m	£749.6m	£774.6m	82%	30.0%	30.0%
			£765.4m		<b>24.4%</b>	<b>24.4%</b>
<b>Customer service in year</b>						
Service incentive mechanism – qualitative	4.33	4.36	4.41	100%	12.0%	12.0%
			4.42		<b>12.0%</b>	<b>12.0%</b>
Service incentive mechanism – quantitative	84	81	78	100%	4.0%	4.0%
			77		<b>4.0%</b>	<b>4.0%</b>
<b>Maintaining and enhancing services for customers</b>						
Wholesale outcome delivery incentive (ODI) composite	(£35.2m)	(£8.8m)	£14.0m	84%	20.0%	20.0%
			£6.7m		<b>16.7%</b>	<b>16.7%</b>
Time, cost and quality of capital programme (TCQi) <sup>(2)</sup>	82%	90%	98%	68%	20.0%	20.0%
		92.9%			<b>13.6%</b>	<b>13.6%</b>
<b>Corporate responsibility</b>						
Dow Jones Sustainability Index rating			World Class	100%	4.0%	4.0%
			100%		<b>4.0%</b>	<b>4.0%</b>
<b>Personal objectives (see page 100 for further detail)</b>						
Steve Mogford				90%	10.0%	
				90%	<b>9.0%</b>	
Russ Houlden				85%		10.0%
				85%		<b>8.5%</b>
<b>Total:</b>						
<b>Actual award (% of maximum)</b>					<b>83.7%</b>	<b>83.2%</b>
Maximum award (% of salary)					130%	130%
<b>Actual award (% of salary) (£'000 – shown in single figure table)<sup>(3)</sup></b>					<b>108.8%</b>	<b>108.2%</b>
					<b>£785k</b>	<b>£492k</b>

(1) The underlying operating profit figure for bonus purposes is based on the underlying operating profit on page 45 and is subject to further adjustments in respect of infrastructure renewals expenditure and property trading. To take into account changes in the scope of business operations from the creation of a joint venture with Severn Trent in June 2016 to provide non-household services (Water Plus), the committee used its discretion to exclude any profits or loss arising from non-household services in the underlying operating profit figure used for assessing the bonus targets and outcome. An underpin applied to this measure based on the prior year figure (adjusted for non-household services) and was aimed at ensuring year-on-year growth in profit.

(2) TCQi is an internal measure which measures the extent to which we deliver our capital projects on time, to budget and to the required quality standard. It is expressed as a percentage, with a higher percentage representing better performance.

(3) Under the Deferred Bonus Plan, 50 per cent of the annual bonus will be deferred in shares for three years.

# Corporate governance report

## Annual report on remuneration

### Further detail of achievement against personal objectives

Personal objectives represent 10 per cent of the total bonus opportunity.

The committee's view is that Steve has performed very strongly against his personal objectives, warranting an outcome of 90 per cent. Key achievements in the year include a step change improvement in customer service, strengthening of relationships with key stakeholders, successful preparation for the opening of the non-household market to competition (including the creation of a joint venture with Severn Trent) and continued development of the talent management process for senior roles.

Russ Houlden has also performed very well against the majority of his personal objectives, warranting an outcome of 85 per cent. Key achievements in the year include outperformance against financing targets, development of relationships with key shareholders and analysts, good progress on emerging areas of regulatory focus and further enhancements to the company's risk management approach.

### Deferred Bonus Plan awards made in year ended 31 March 2017 (audited information)

Bonuses are earned by reference to performance in the financial year and paid in June following the end of the financial year. Fifty per cent of any bonus is deferred into shares under the Deferred Bonus Plan. These awards vest after three years and are subject to withholding provisions. There are no service or additional performance conditions attached.

The table below provides details of share awards made during the year in respect of bonus payments made in 2016/17. The face value of each award reflects half of the value shown for 2015/16 in the single figure table.

Executive Director	Type of award	Basis of award	Face value of awards <sup>(1)</sup> (£'000)	End of deferral period
Steve Mogford	Conditional shares	50% of bonus	£250	16/06/2019
Russ Houlden	Conditional shares	50% of bonus	£157	16/06/2019

(1) The face value has been calculated using the closing share price on 15 June 2016 (the dealing day prior to the date of grant) which was 924 pence per share.

### Annual bonus in respect of financial year commencing 1 April 2017

The maximum bonus opportunity for the year commencing 1 April 2017 will remain unchanged at 130 per cent of base salary.

The annual bonus will operate in a broadly similar way as that for the year 2016/17, with the exception that the Dow Jones measure (currently representing a maximum of four per cent of executive directors' bonuses) will be removed from the bonus scorecard and the weighting redistributed to the outcome delivery incentive (ODI) measure. The ODI targets, introduced in 2015, cover a broad range of customer priorities which closely link to the sustainable delivery of company performance, such as water quality, reliability of supply and wastewater network performance. The ODI targets also have a direct financial impact on shareholder value, and so on a going forward basis will, in the committee's view, form a stronger measure of performance for customers and shareholders than the Dow Jones measure.

In addition, in line with the revised policy, recovery and withholding provisions for the annual bonus will be made more robust on an ongoing basis.

The table below summarises the measures, weighting and targets for the 2017/18 bonus. Please note that the majority of targets are considered commercially sensitive, and consequently these will be disclosed in the 2017/18 annual report on remuneration.

Measure	Targets			Weighting (% of award)
	Threshold (25% vesting)	Target (50% vesting)	Stretch (100% vesting)	
<b>Underlying operating profit</b> <sup>(1)</sup>	Commercially sensitive			30.0%
<b>Customer service in year</b>				
Service incentive mechanism – qualitative	Commercially sensitive			12.0%
Service incentive mechanism – quantitative	Commercially sensitive			4.0%
<b>Maintaining and enhancing services for customers</b>				
Wholesale outcome delivery incentive (ODI) composite	Commercially sensitive			24.0%
Time, cost and quality of capital programme (TCQi) <sup>(2)</sup>	85%	90%	98%	20.0%
<b>Personal objectives</b>	Commercially sensitive			10.0%
<b>Total:</b>				<b>100%</b>

(1) Underlying operating profit for bonus purposes is subject to a number of adjustments, principally in regard to infrastructure renewals expenditure and property trading.

(2) TCQi is an internal measure which measures the extent to which we deliver our capital projects on time, to budget and to the required quality standard. It is expressed as a percentage, with a higher percentage representing better performance. For 2017/18 there will be some changes to the way the cost element of TCQi is measured.

## Long-term incentives

### Performance for Long Term Plan awards

2014 Long Term Plan (LTP) awards with a performance period ended 31 March 2017 (audited information)

The 2014 LTP awards were granted in July 2014 and performance was measured over the three-year period 1 April 2014 to 31 March 2017. Executive directors' awards will normally vest in April 2019, following an additional two-year holding period. The unvested shares will remain subject to withholding provisions over this two-year holding period.

Note that the final outcome for the customer service excellence measure (which forms one-third of the award) will not be known until Ofwat publishes the combined service incentive mechanism scores for the company and its comparator water companies (expected to be published in late summer 2017). The values of the 2014 LTP awards in the single total figure of remuneration table are therefore estimated and will be restated in next year's report once the final outcome is known.

The table below shows how the long-term incentive amount in respect of the 2014 LTP was calculated:

Measure	Achieved			Payout as a % of maximum	Steve Mogford weighting (% of award)	Russ Houlden weighting (% of award)
	Threshold (25% vesting)	Intermediate (80% vesting)	Stretch (100% vesting)		Outcome	Outcome
<b>Relative total shareholder return (TSR)</b>						
TSR versus median TSR of FTSE 100 companies (excluding financial services, oil and gas, and mining companies) <sup>(1)</sup>	Median TSR	–	Median TSR × 1.15	100.0%	33.3%	33.3%
	Greater than median TSR x1.15				<b>33.3%</b>	<b>33.3%</b>
	Company TSR of 43.8% was above stretch TSR of 42.2%					
<b>Sustainable dividends</b>						
Dividend growth in years ended 31 March 2016 and 31 March 2017	RPI+0%	–	RPI+2%	25.0%	33.3%	33.3%
	RPI +0% <sup>(2)</sup>				<b>8.3%</b>	<b>8.3%</b>
Underpin 1:	✓ Met	At least RPI+2% growth in year ended 31 March 2015				
Underpin 2:	✓ Met	Average underlying dividend cover of at least 1.1 over the three-year performance period				
<b>Customer service excellence</b>						
Ranking for the year ended 31 March 2017 versus 17 other water companies using Ofwat's service incentive mechanism (SIM) combined score	Median rank	Upper quartile rank	Upper decile rank	52.5%	33.3%	33.3%
	Estimate: Rank 7th out of 18				<b>17.5%</b>	<b>17.5%</b>
	Note that this is an estimate as the final outcome will not be known until the combined scores are published later in 2017.					
<b>Overall underpin</b>						
Overall vesting is subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance	✓ Assumed met.		Note that the committee will make a final assessment of the company's performance once the combined SIM score is known.			
<b>Estimated vesting (% of award)</b>					<b>59.1%</b>	<b>59.1%</b>
<b>Number of shares granted</b>					100,692	63,560
<b>Number of dividend equivalent shares</b>					9,793	6,181
<b>Number of shares before performance conditions applied</b>					110,485	69,741
<b>Estimated number of shares after performance conditions applied</b>					65,296	41,216
<b>Three-month average share price at end of performance period<sup>(3)</sup></b>					9.46	9.46
<b>Estimated value at end of performance period (£'000 – shown in single figure table)</b>					<b>617</b>	<b>390</b>

(1) For the purposes of calculating TSR, the TSR index is averaged over the three months prior to the start and end of the performance period. TSR is independently calculated by New Bridge Street.

(2) Subject to approval of the final dividend by shareholders at the 2017 AGM.

(3) Average share price over the three-month period 1 January 2017 to 31 March 2017.

# Corporate governance report

## Annual report on remuneration

### Long Term Plan awards granted in the year

2016 LTP awards with a performance period ending 31 March 2019 (audited information)

The table below provides details of share awards made during the year in respect of the 2016 LTP:

Executive Director	Type of award	Basis of award	Face value of award (£'000) <sup>(1)</sup>	Number of shares under award	% vesting at threshold	End of performance period <sup>(2)</sup>
Steve Mogford	Conditional shares	130% of salary	£927	98,763	25%	31/03/2019
Russ Houlden	Conditional shares	130% of salary	£585	62,333	25%	31/03/2019

(1) The face value has been calculated using the closing share price on 27 June 2016 (the dealing day prior to the date of grant) which was 938.5 pence per share.

(2) An additional two-year holding period applies after the end of the three-year performance period.

Details about the 2016 LTP performance measures and targets are shown in the following table. Performance is measured over the three-year period 1 April 2016 to 31 March 2019. The table on page 90 summarises how these performance measures are linked to our business strategy.

Measure	Targets			Weighting
	Threshold (25% vesting)	Intermediate	Stretch (100% vesting)	
<b>Relative total shareholder return (TSR)</b>				
TSR versus median TSR of FTSE 100 companies (excluding financial services, oil and gas, and mining companies). <sup>(1)</sup> Measured over the three-year performance period	Median TSR	Straight-line between threshold and stretch	Median TSR x1.15	33.3%
<b>Sustainable dividends</b>				
Average underlying dividend cover over the three-year performance period	The targets are considered commercially sensitive and so are not disclosed in this report. However, actual targets, performance achieved and awards made will be published retrospectively so that shareholders can fully understand the basis for any pay-outs			33.3%
Underpin	Dividend growth of at least RPI in each of the years ending 31 March 2017, 31 March 2018 and 31 March 2019			
<b>Customer service excellence</b>				
Ranking for the year ending 31 March 2019 versus 17 other water companies using Ofwat's Service Incentive Mechanism (SIM) combined score	Median rank	Upper quartile rank (80% vesting)	Upper decile rank	33.3%
<b>Overall underpin</b>				
Overall vesting is subject to the committee being satisfied that the company's performance on these measures is consistent with underlying business performance				

(1) For the purposes of calculating TSR, the TSR index is averaged over the three months prior to the start and end of the performance period. TSR is independently calculated by New Bridge Street.

Straight-line vesting applies between the threshold, intermediate and stretch targets, with nil vesting below threshold performance. The committee will have the flexibility to make appropriate adjustments to the performance targets in exceptional circumstances, to ensure that the award achieves its original purpose.

### Performance targets for future Long Term Plan awards

2017 LTP awards with a performance period ending 31 March 2020

There will be broad consistency in the approach to how the 2017 Long Term Plan (LTP) awards will operate.

The performance targets for the total shareholder return measure are expected to be as for the 2016 LTP awards; the targets for the sustainable dividends measure will be reviewed to ensure that they are appropriate for the performance period 1 April 2017 to 31 March 2020; and the customer service excellence targets will change such that: (i) Ofwat's SIM will be measured against a smaller group of the nine other companies providing both water and sewerage services; and (ii) 25 per cent will vest at median and 100 per cent at upper quartile, with straight-line vesting between these points. The change to the customer service excellence SIM targets, which was subject to consultation with major shareholders during the year, is aimed at ensuring that performance is compared to companies whose service provision is most similar to United Utilities and at setting an appropriate level of stretch (the committee considers upper quartile performance to be a sufficiently challenging target to merit a full payout and, further, historically there has not been any additional economic reward for achieving above upper quartile SIM performance). Back-testing since 2010/11, when SIM was first introduced as a measure, demonstrates that below threshold performance (i.e. nil vesting) would have been achieved under both the current and new customer service excellence targets, except for in 2013/14 when the threshold level of vesting (25 per cent) would have been achieved under the new measure.

## External appointments

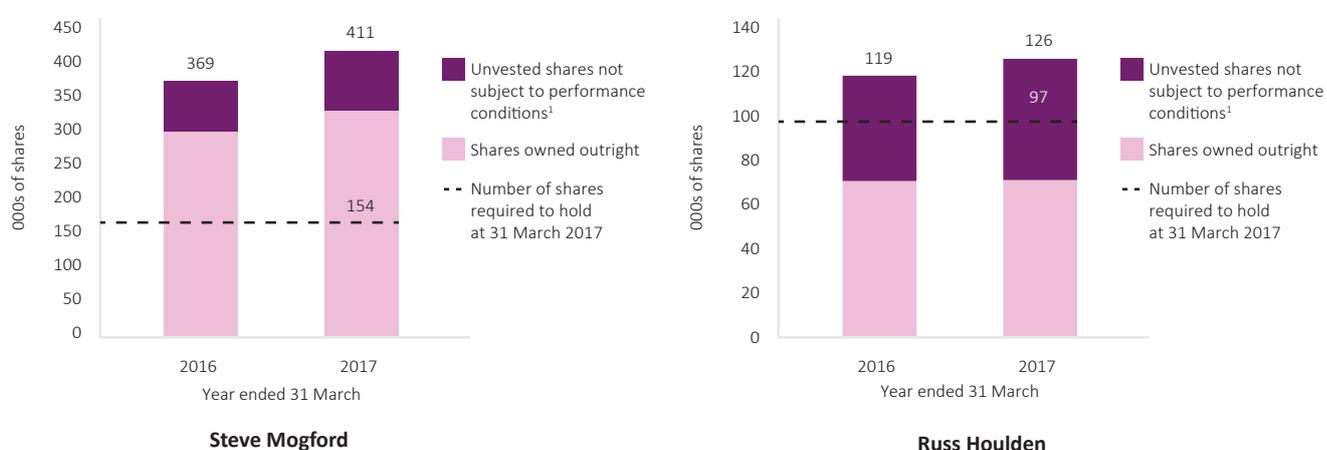
Steve Mogford was appointed as a senior independent director of G4S PLC in May 2016 for which he received and retained a fee of £46,000 for 2016. Russ Houlden is an independent member of the supervisory board, and audit committee chairman, of Orange Polska SA for which he receives and retains fees estimated annually at around £77,000.

## Executive directors' interests in shares

### Executive directors' shareholdings (audited information)

Executive directors are normally expected to reach a shareholding guideline of 200 per cent of salary within five years of appointment. There is also an expectation that they will continue to build a shareholding throughout their period of employment with the company after the guideline is reached.

Details of beneficial interests in the company's ordinary shares as at 31 March 2017 held by each of the executive directors and their connected persons are set out in the charts below along with progress against the target shareholding guideline level. The charts below show that both Steve Mogford and Russ Houlden have exceeded the target shareholding.



(1) After tax and national insurance.

Further detail of the executive directors' shareholdings is given in the table below and in the appendix on page 109.

Director	Shareholding guideline (% of salary)	Number of shares required to meet shareholding guideline <sup>(1)</sup>	Number of shares owned outright (including connected persons)		Unvested shares not subject to performance conditions <sup>(2)</sup>		Total shares counting towards shareholding guidelines <sup>(3)</sup>		Shareholding as % of base salary at 31 March 2017 <sup>(4)</sup>	Shareholding guideline met at 31 March 2017	Unvested shares subject to performance conditions <sup>(4)</sup>	
			2017	2016	2017	2016	2017	2016			2017	2016
Steve Mogford <sup>(5)</sup>	200%	153,759	327,287	297,164	157,289	135,813	410,668	369,163	534%	Yes	314,125	338,869
Russ Houlden <sup>(5)</sup>	200%	97,077	73,500	73,196	99,127	85,726	126,056	118,649	260%	Yes	198,286	213,897

(1) Share price used is the average share price over the three months from 1 January 2017 to 31 March 2017 (945.6 pence per share).

(2) Unvested shares subject to no further performance conditions such as matching shares under the ShareBuy scheme. Includes shares only subject to withholding provisions such as the Deferred Bonus Plan shares in the three-year deferral period and Long Term Plan shares in the two-year holding period.

(3) Includes unvested shares not subject to performance conditions (on a net of tax and national insurance basis), plus the number of shares owned outright.

(4) Includes unvested shares under the Long Term Plan.

(5) In the period 1 April 2017 to 24 May 2017, additional shares were acquired by Steve Mogford (30 ordinary shares) and Russ Houlden (29 ordinary shares) in respect of their regular monthly contributions to the ShareBuy scheme. These will be matched by the company on a one-for-five basis. Under the scheme, matching shares vest provided the employee remains employed by the company one year after grant.

# Corporate governance report

## Annual report on remuneration

### Other information

#### Performance and CEO remuneration comparison

This graph illustrates the company's performance against the FTSE 100 over the past eight years. The FTSE 100 has been chosen as the appropriate comparator as the company is a member of the FTSE 100 and it is considered to be the most widely published benchmark for this purpose. The table below the TSR chart shows the remuneration data for the CEO over the same eight-year period as the TSR chart.



Year ended 31 March		2010	2011	2012	2013	2014	2015	2016	2017
CEO single figure of remuneration (£000)	Steve Mogford	n/a	377	1,421	1,549	2,378	2,884	2,858 <sup>(1)</sup>	<b>2,310</b>
	Philip Green	1,992	3,073	n/a	n/a	n/a	n/a	n/a	<b>n/a</b>
Annual bonus payment (% of maximum)	Steve Mogford	n/a	90.6	72.0	84.4	78.2	77.4	54.5	<b>83.7</b>
	Philip Green	89.2	90.8	n/a	n/a	n/a	n/a	n/a	<b>n/a</b>
LTP vesting (% of maximum) <sup>(2)</sup>	Steve Mogford	n/a	n/a <sup>(3)</sup>	n/a <sup>(3)</sup>	n/a <sup>(3)</sup>	93.5	97.5	33.6 <sup>(4)</sup>	<b>59.1<sup>(6)</sup></b>
								100 <sup>(5)</sup>	
	Philip Green	0 <sup>(7)</sup>	28.1 <sup>(9)</sup>	n/a	n/a	n/a	n/a	n/a	<b>n/a</b>
		100 <sup>(8)</sup>	12.5 <sup>(10)</sup>						

(1) This includes the estimated pay-out from the 2013 Long Term Plan (LTP) as well as £1.028 million in respect of Steve Mogford's one-off Matched Share Investment Scheme which ended on 5 January 2016. The estimated pay-out from the 2013 LTP has been restated to reflect the additional dividend equivalents accruing on these awards and updated share price – see page 101 for further details.

(2) For performance periods ended on 31 March, unless otherwise stated.

(3) Steve Mogford was not a participant in any long-term incentive plans that had performance periods ending during 2011 to 2013. For those who did participate in those plans, the vesting as a percentage of maximum was 37.5 per cent for those vesting in 2012 and 35.3 per cent for those vesting in 2013.

(4) 2013 LTP.

(5) The retention period applicable to Steve Mogford's Share Investment Scheme ended on 5 January 2016.

(6) The 2014 Long Term Plan amount vesting percentage is estimated (see page 101 for further details).

(7) 2007 Performance Share Plan (PSP).

(8) 2007 Matching Share Award Plan (MSAP).

(9) 2008 PSP and MSAP.

(10) The retention period applicable to Philip Green's Matched Share Investment Scheme ended on 12 February 2011.

#### Date of service contracts

Executive directors	Date of service contract
Steve Mogford	5.1.11
Russ Houlden	1.10.10

### Percentage change in CEO's remuneration versus the wider workforce

The figures below show how the percentage change in the CEO's salary, benefits and bonus earned in 2015/16 and 2016/17 compares with the percentage change in the average of each of those components for a group of employees.

#### Change in CEO remuneration<sup>(1)</sup>



#### Change in employee remuneration<sup>(4)</sup>



- (1) See single total figure of remuneration table on page 98 for more information.
- (2) On 1 September 2016, Steve Mogford received a base salary increase of 2.0 per cent.
- (3) As disclosed in last year's directors' remuneration report the committee had used its discretion to reduce the 2015/16 bonus outcome for the executive directors in relation to the water quality incident in Lancashire. This reduction was not applied to the wider workforce.
- (4) To aid comparison, the group of employees selected by the committee are all those members of the workforce who were employed over the complete two-year period.
- (5) Includes promotional increases. Headline salary increase for employees was 2.0 per cent.

### Relative importance of spend on pay

The chart below shows the relative importance of spend on pay compared to distributions to shareholder.



- (1) Employee costs include wages and salaries, social security costs, and post-employment benefits.

# Corporate governance report

## Annual report on remuneration

### Non-executive directors

Single total figure of remuneration for non-executive directors (audited information)

	Salary/fees £'000		Taxable benefits £'000		Total £'000	
	2017	2016	2017	2016	2017	2016
Dr John McAdam	294	287	1	1	295	288
Dr Catherine Bell <sup>(1)</sup>	22	71	1	1	23	72
Stephen Carter	70	62	1	0	71	62
Mark Clare	76	75	1	0	77	75
Alison Goligher <sup>(2)</sup>	43	n/a	0	n/a	43	n/a
Brian May	78	77	1	0	79	77
Sara Weller	76	75	0	0	76	75

(1) Catherine Bell retired from the board on 22 July 2016

(2) Alison Goligher joined the board on 1 August 2016

### Fees

Non-executive director annual fee rates were reviewed and increased with effect from 1 September 2016 as shown below:

Role	Fees £'000	
	1 Sept 2016	1 Sept 2015
Base fees: Chairman <sup>(1)</sup>	296.0	290.0
Base fees: other non-executive directors <sup>(2)</sup>	64.0	62.6
Senior independent non-executive director <sup>(2)</sup>	12.5	12.5
Chair of audit and treasury committees <sup>(2)</sup>	15.0	15.0
Chair of remuneration committee <sup>(2)</sup>	12.5	12.5
Chair of corporate responsibility committee <sup>(2)</sup>	10.0	10.0

(1) Approved by the remuneration committee.

(2) Approved by a separate committee of the board.

### Non-executive directors' shareholdings (audited information)

Details of beneficial interests in the company's ordinary shares as at 31 March 2017 held by each of the non-executive directors and their connected persons are set out in the table below:

	Number of shares owned outright (including connected persons) at 31 March 2017 <sup>(1)</sup>
Dr John McAdam	1,837
Stephen Carter	3,075
Mark Clare	7,628
Alison Goligher	3,000
Brian May	3,000
Sara Weller	11,000

(1) From 1 April 2017 to 24 May 2017 there have been no movements in the shareholdings of the non-executive directors.

Non-executive directors	Date first appointed to the board
Dr John McAdam	4.2.08
Stephen Carter	1.9.14
Mark Clare	1.11.13
Alison Goligher	1.8.16
Brian May	1.9.12
Sara Weller	1.3.12

## The remuneration committee

### Summary terms of reference

The committee's terms of reference were last reviewed in November 2016 and are available on our website:

[corporate.unitedutilities.com/corporate-governance](http://corporate.unitedutilities.com/corporate-governance)

### Composition of the remuneration committee

The committee's main responsibilities include:

- › making recommendations to the board on the company's framework of executive remuneration and its cost;
- › approving the individual employment and remuneration terms for executive directors and other senior executives, including: recruitment and severance terms, bonus plans and targets, and the achievement of performance against targets;
- › approving the general employment and remuneration terms for selected senior employees;
- › approving the remuneration of the Chairman;
- › proposing all new long-term incentive schemes for approval of the board, and for recommendation by the board to shareholders; and
- › assisting the board in reporting to shareholders and undertaking appropriate discussions as necessary with institutional shareholders on aspects of executive remuneration.

Role	Member since	Member to
Sara Weller (chair since 27.7.12)	1.3.12	To date
Dr Catherine Bell <sup>(1)</sup>	1.3.11	22.7.16
Mark Clare	1.9.14	To date
Alison Goligher	1.8.16	To date
Brian May	16.5.17	To date

<sup>(1)</sup> Catherine Bell retired from the board on 22 July 2016.

The committee's members have no personal financial interest in the company other than as shareholders and the fees paid to them as non-executive directors.

### Advisors to the remuneration committee

By invitation of the committee, meetings are also attended by the Chairman of the company (Dr John McAdam), the CEO (Steve Mogford), the company secretary (Simon Gardiner, who acts as secretary to the committee), the business services director (Sally Cabrini) and the head of reward and pensions (Ruth Henshaw), who are consulted on matters discussed by the committee, unless those matters relate to their own remuneration. Advice or information is also sought directly from other employees where the committee feels that such additional contributions will assist the decision-making process.

The committee is authorised to take such internal and external advice as it considers appropriate in connection with carrying out its duties, including the appointment of its own external remuneration advisors.

During the year, the committee was assisted in its work by the following external advisor:

Advisor	Appointed by	How appointed	Services provided to the committee in year ended 31 March 2017	Fees paid by company for these services in respect of year and basis of charge
New Bridge Street	Committee	Reappointed following committee review in 2013	General advice on remuneration matters	£148,000 Time/cost basis

Other services provided to the company

— Benchmarking of roles not under the committee's remit and advice on non-executive director remuneration

The independent consultants New Bridge Street (a trading name of Aon Hewitt Limited, an Aon PLC company) are members of the Remuneration Consultants Group and, as such, voluntarily operate under the Code of Conduct in relation to executive remuneration consulting in the UK. The committee is satisfied that the advice they received from external advisors is objective and independent.

In addition, during the year the law firms Eversheds Sutherland and Slaughter and May provided advice on the company's share schemes to the company.

# Corporate governance report

## Annual report on remuneration

### Key activities of the remuneration committee over the past year

The committee met six times in the year ended 31 March 2017.

#### Regular activities

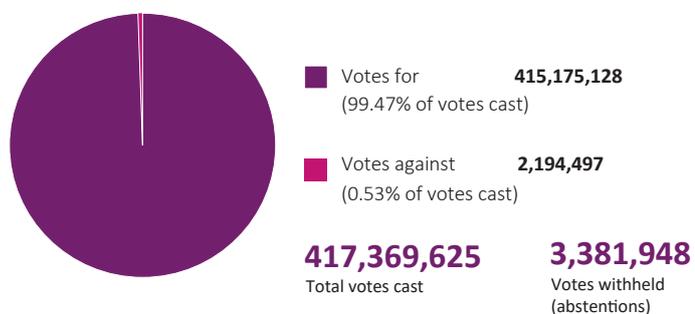
- › Approved the 2015/16 directors' remuneration report
- › Reviewed the pay comparator group
- › Reviewed the base salaries of executive directors and other members of the executive team
- › Reviewed the base fee for the Chairman
- › Assessed the achievement of targets for the 2015/16 annual bonus scheme, reviewed progress against the targets for the 2016/17 annual bonus scheme, and set the targets for the 2017/18 annual bonus scheme
- › Assessed the achievement of targets for the Long Term Plan (LTP) awards made in 2013 and set the targets for LTP awards made in 2016
- › Reviewed and approved awards made under the annual bonus scheme, Deferred Bonus Plan (DBP) and LTP
- › Monitored progress against shareholding guidelines for executive directors and other members of the executive team
- › Reviewed the committee's performance during the period
- › Reviewed the committee's terms of reference
- › Considered governance developments and market trends in executive remuneration, including in the wider utilities sector.

#### Other activities

- › Reviewed the executive pay arrangements and consulted with shareholders on the proposed remuneration policy
- › Considered level playing field requirements for incentives following the opening of the non-household market to full competition from 1 April 2017

### 2016 AGM: Statement of voting

At the last Annual General Meeting on 22 July 2016, votes on the 2015/16 directors' remuneration report (other than the part containing the directors' remuneration policy) were cast as follows:



The directors' remuneration report was approved by the board of directors on 24 May 2017 and signed on its behalf by:

**Sara Weller**

Chair of the remuneration committee

## Appendix: Executive directors' share plan interests 1 April 2016 to 31 March 2017

	Award date	Awards held at 1 April 2016	Granted in year	Notional dividends accrued in year <sup>(1)</sup>	Vested in year	Lapsed/ forfeited in year	Awards held at 31 March 2017
<b>Steve Mogford</b>							
<b>Shares not subject to performance conditions at 31 March 2017</b>							
DBP	17.6.13	56,389	–	–	56,389	–	–
DBP	30.6.14	41,145	–	1,644	–	–	42,789
DBP	16.6.15	38,240	–	1,528	–	–	39,768
DBP <sup>(2)</sup>	16.6.16	–	27,087	1,082	–	–	28,169
LTP	29.7.13	133,148	–	1,788	–	88,411	46,525
ShareBuy matching shares <sup>(3)</sup> to 31.3.17	1.4.16	39	38	–	39	–	38
<b>Subtotal</b>		<b>268,961</b>	<b>27,125</b>	<b>6,042</b>	<b>56,428</b>	<b>88,411</b>	<b>157,289</b>
<b>Shares subject to performance conditions at 31 March 2017</b>							
LTP	30.6.14	106,237	–	4,248	–	–	110,485
LTP	30.6.15	99,484	–	3,977	–	–	103,461
LTP <sup>(4)</sup>	28.6.16	–	98,763	1,416	–	–	100,179
<b>Subtotal</b>		<b>205,721</b>	<b>98,763</b>	<b>9,641</b>	<b>0</b>	<b>0</b>	<b>314,125</b>
<b>TOTAL</b>		<b>474,682</b>	<b>125,888</b>	<b>15,683</b>	<b>56,428</b>	<b>88,411</b>	<b>471,414</b>
<b>Russ Houlden</b>							
<b>Shares not subject to performance conditions at 31 March 2017</b>							
DBP	17.6.13	35,578	–	–	35,578	–	–
DBP	30.6.14	25,969	–	1,037	–	–	27,006
DBP	16.6.15	24,140	–	964	–	–	25,104
DBP <sup>(2)</sup>	16.6.16	–	16,940	677	–	–	17,617
LTP	29.7.13	84,029	–	1,128	–	55,796	29,361
ShareBuy matching shares <sup>(3)</sup> to 31.3.17	1.4.16	39	39	–	39	–	39
<b>Subtotal</b>		<b>169,755</b>	<b>16,979</b>	<b>3,806</b>	<b>35,617</b>	<b>55,796</b>	<b>99,127</b>
<b>Shares subject to performance conditions</b>							
LTP	30.6.14	67,060	–	2,681	–	–	69,741
LTP	30.6.15	62,808	–	2,511	–	–	65,319
LTP <sup>(4)</sup>	28.6.16	–	62,333	893	–	–	63,226
<b>Subtotal</b>		<b>129,868</b>	<b>62,333</b>	<b>6,085</b>	<b>0</b>	<b>0</b>	<b>198,286</b>
<b>TOTAL</b>		<b>299,623</b>	<b>79,312</b>	<b>9,891</b>	<b>35,617</b>	<b>55,796</b>	<b>297,413</b>

(1) Note that these are also subject to performance conditions where applicable.

(2) See page 100 for further information.

(3) Under ShareBuy, matching shares vest provided the employee remains employed by the company one year after grant. During the year Steve Mogford purchased 191 partnership shares and was awarded 38 matching shares (at an average share price of 944 pence per share). Russ Houlden purchased 191 partnership shares and was awarded 39 matching shares (at an average share price of 943 pence per share).

(4) See page 102 for further information.

### Dilution limits

Awards granted under the Company's share plans are satisfied by market purchased shares bought on behalf of the company by United Utilities Employee Share Trust immediately prior to the vesting of a share plan. The company does not make regular purchases of shares into the Trust nor employ a share purchase hedging strategy and shares are bought to satisfy the vesting of share plans. The rules of the Deferred Bonus Plan do not permit awards to be satisfied by newly issued issues and must be satisfied by market purchased shares. The rules of the Long Term Plan permit the awards to be satisfied by newly issued shares but the company has decided to satisfy awards by market purchased shares.

Should the company's method of satisfying share plan vestings change (i.e. issuing new shares) then the company would monitor the number of shares issued and their impact on dilution limits set by The Investment Association in respect of all share plans (10 per cent in any rolling 10-year period) and executive share plans (5 per cent in any rolling 10-year period).

No treasury shares were held or utilised in the year ended 31 March 2017.

# Corporate governance report

## Tax policies and objectives

Consistent with our wider business objectives, we are committed to acting in a responsible manner in relation to our tax affairs.

Our tax policies and objectives, which are approved by the board on an annual basis, ensure that we:

- › only engage in reasonable tax planning aligned with our commercial activities and we always comply with what we believe to be both the letter and the spirit of the law;
- › do not engage in aggressive or abusive tax avoidance;
- › are committed to an open, transparent and professional relationship with HMRC based on mutual trust and collaborative working; and
- › maintain a robust governance and risk management framework to ensure that these policies and objectives are applied at all levels

In line with the above, we expect to fully adhere to the new HMRC framework for co-operative compliance.

Under the regulatory framework the group operates within, the majority of any benefit from reduced tax payments will typically not be retained by the group but will pass to customers via reduced bills.

In any given year, the group's effective cash tax rate on underlying profits may fluctuate from the standard UK rate due to the available tax deductions on capital investment and pension contributions. These deductions are achieved as a result of utilising tax incentives, which have been explicitly put in place by successive governments precisely to encourage such investment. This reflects responsible corporate behaviour in relation to taxation.

Consistent with the group's general risk management framework, any tax risks are assessed for the likelihood of occurrence and the negative financial or reputational impact on the group and its objectives, should the event occur. In any given period, the key tax risk is likely to be the introduction of unexpected legislative or tax practice changes which lead to increased cash outflow which has not been reflected in the current regulatory settlement. The group is committed to actively engaging with relevant authorities in order to manage any such risk.

The group's principal subsidiary, United Utilities Water Limited (UW), operates solely in the UK and its customers are based here. All of the group's profits are taxable in the UK (other than profits relating to the group's 35 per cent holding in Tallinn Water which are fully taxable in Estonia).

In addition to corporation tax, the group pays and bears significant further annual economic contributions, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees, such as water abstraction charges. The annual amount payable is disclosed within the 'our performance' tax section of the report.

We expect the above details, which apply for both financial years ended 31 March 2017 and 31 March 2018, to comply fully with the new legislative requirements for 'Publication of Group Tax Strategies' for UK groups.

# Directors' report

## Statutory and other information

Gross carbon emissions for 2016/17

# 452,301

tonnes CO<sub>2</sub> equivalent (tCO<sub>2</sub>e)  
22.8 per cent below our 2005/06 baseline

# 149GWh

generated from renewables in 2016/17  
equivalent to 18 per cent of our electricity consumption

Our directors present their management report including the strategic report on pages 10 to 49 and the audited financial statements of United Utilities Group PLC (the company) and its subsidiaries (together referred to as the group) for the year ended 31 March 2017.

### Business model

A description of the company's business model can be found within the strategic report on pages 14 to 30.

### Greenhouse gas emissions

We measure our emissions over the financial reporting year against a footprint covering all our operational activities in the UK. All figures stated are in line with the latest UK Government carbon reporting guidance. Our reporting is compliant with the international carbon reporting standard (ISO 14064, Part 1) and assured by the Certified Emissions Measurement and Reduction Scheme (CEMARS)

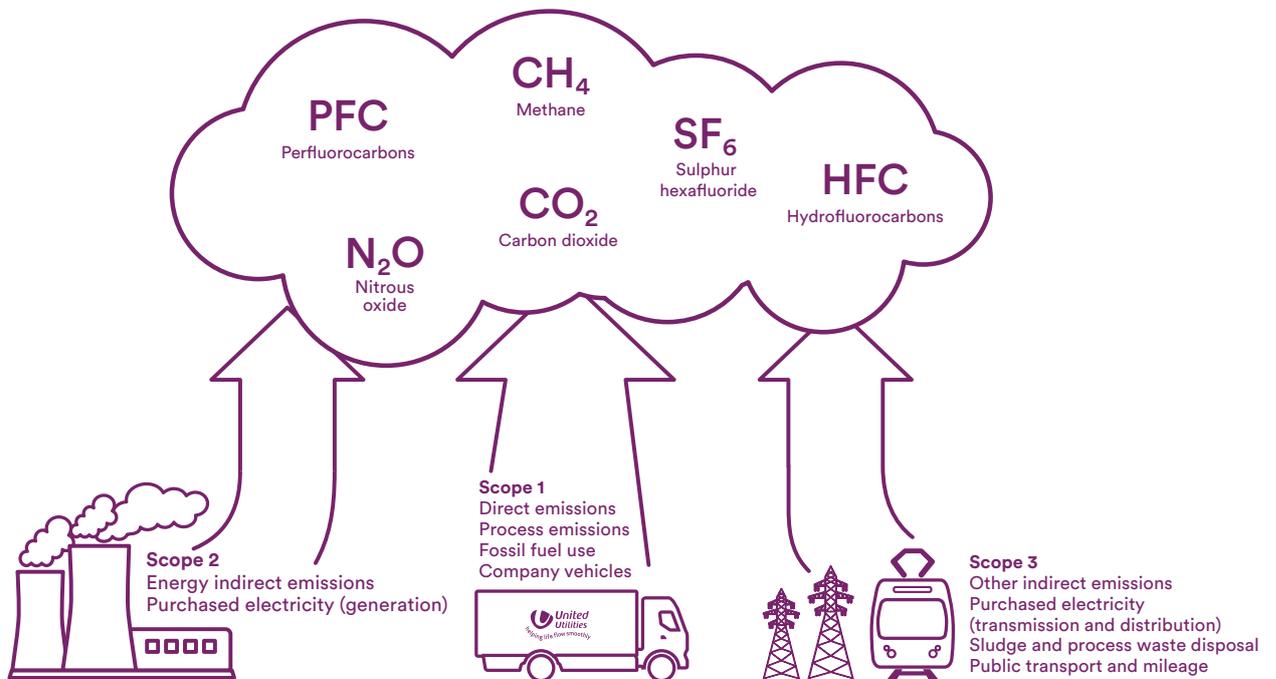
Our emissions account for all six Kyoto Protocol gases – converted to carbon dioxide equivalents. There are no material omissions.

### Carbon

The boundary of our carbon footprint includes both direct and indirect emissions resulting from our operations.

Direct emissions are those from activities we own or control including those from our treatment processes, company vehicles and burning of fossil fuels for heating or incineration of sewage sludge.

Indirect emissions result from operational activities we do not own or control. These include indirect energy emissions produced as a consequence of electricity we purchase to power our treatment plants and other indirect emissions as a consequence of our activities, e.g. from travel on company business and sludge and process waste disposal emissions.

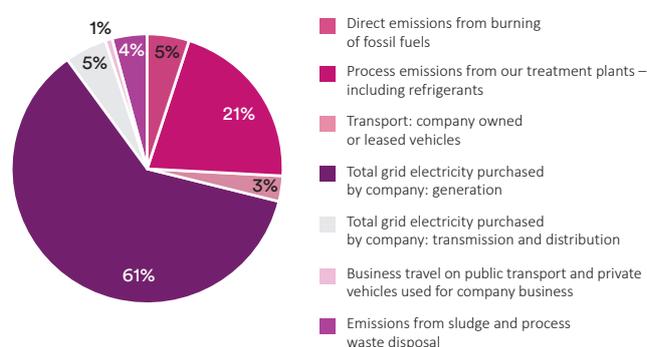


# Directors' report

## Statutory and other information

We monitor our operational carbon emissions against a target, which is aligned to our investment cycle. In 2020 (end of AMP6) we will aim to reduce our emissions by 50 per cent on the 2005/06 baseline and continue to reduce emissions to achieve 60 per cent by 2035 (end of AMP9).

Our performance in 2016/17 was 452,301 tCO<sub>2</sub>e which is 22.8 per cent below the 2005/06 baseline. The trend in our overall emissions continues to be downwards although both the level and proportion of each component fluctuates year by year as they are affected by weather, operational conditions and the carbon content of the UK's electricity supply.

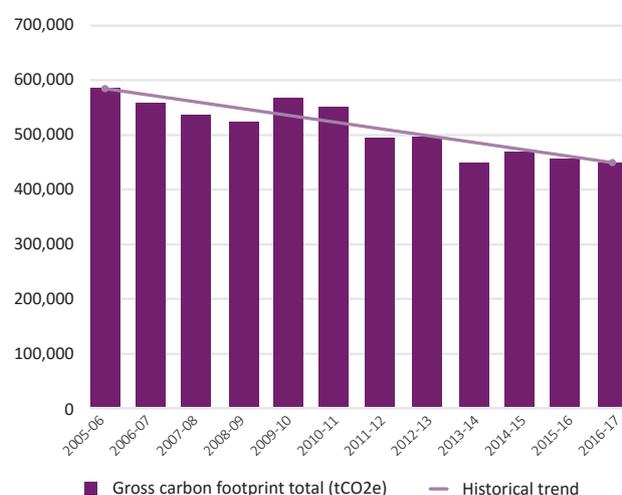


We expect the overall trend in our emissions to remain downwards reflecting our continued efforts to use less energy and increase renewable energy generation, alongside projected decreases in the carbon content of the UK's energy supply.

The majority of our emissions are as a result of our use of grid electricity. In 2016/17 we purchased more grid electricity than the previous year but emissions reduced due to a 10.8 per cent reduction in the carbon intensity of the UK grid emissions factor.

The company generated the equivalent of 149GWh of electricity from renewable sources. This is an increase of 8GWh compared to last year and is a result of our investment in energy recovery and generation from wind and solar photovoltaics.

Our carbon footprint since 2005/06 – our baseline year



Greenhouse gas emissions Scope	Source	2014/15 (tCO <sub>2</sub> e)	2015/16 (tCO <sub>2</sub> e)	2016/17 (tCO <sub>2</sub> e)	
Scope 1 Direct emissions	Direct emissions from burning of fossil fuels	9,575	12,283	20,848	
	Process emissions from our treatment plants -including refrigerants	83,762	87,004	96,019	128,649
	Transport: company owned or leased vehicles	10,704	11,246	11,783	
Scope 2 Energy indirect emissions	Total grid electricity purchased by the company: generation	321,185	302,791	277,727	277,727
Scope 3 Other indirect emissions	Total grid electricity purchased by the company: transmission and distribution	28,086	25,006	25,120	
	Business travel on public transport and private vehicles used for company business	2,971	2,783	2,889	45,924
	Emissions from sludge and process waste disposal	17,425	13,744	17,915	
<b>Gross carbon footprint total</b>		<b>473,708</b>	<b>454,857</b>	<b>452,301</b>	
	Emission reductions from exported renewable electricity	(6,155)	(4,209)	(4,417)	
	Emission reductions from exported biomethane	–	–	(3,240)	
<b>Net carbon footprint total</b>		<b>467,553</b>	<b>450,648</b>	<b>444,644</b>	
<b>Emissions per £million turnover</b>		<b>275.44</b>	<b>262.92</b>	<b>265.43</b>	

<b>Dividends</b>	Our directors are recommending a final dividend of 25.92 pence per ordinary share for the year ended 31 March 2017, which, together with the interim dividend of 12.95 pence, gives a total dividend for the year of 38.87 pence per ordinary share (the interim and final dividends we paid in respect of the 2015/16 financial year were 12.81 pence and 25.64 pence per ordinary share respectively). Subject to approval by our shareholders at our AGM, our final dividend will be paid on 4 August 2017 to shareholders on the register at the close of business on 23 June 2017.
<b>Directors</b>	The names of our directors who served during the financial year ended 31 March 2017 can be found on pages 52 and 54.
<b>Reappointment</b>	Our articles of association provide that our directors must retire at the third annual general meeting following their last election or reappointment by our shareholders. However, our board, being mindful of the recommendation contained within the UK Corporate Governance Code published in 2014 ('the Code') that all directors should be subject to annual election by shareholders, has decided that all of our directors will retire at AGMs and offer themselves for election/reappointment, as has happened at all the AGMs since 2011. Information regarding the appointment of our directors is included in our corporate governance report on pages 66 to 70.
<b>Interests</b>	Details of the interests in the company's shares held by our directors and persons connected with them are set out in our directors' remuneration report on pages 86 to 109 which is hereby incorporated by reference into this directors' report.
<b>Corporate governance statement</b>	The corporate governance report on pages 52 to 110 is hereby incorporated by reference into this directors' report and includes details of our compliance with the Code. Our statement includes a description of the main features of our internal control and risk management systems in relation to the financial reporting process and forms part of this directors' report. A copy of the 2014 Code, as applicable to the company for the year ended 31 March 2017, can be found at the Financial Reporting Council's website <a href="http://frc.org.uk">frc.org.uk</a> . Copies of the matters reserved for the board and the terms of reference for each of the main board committees can be found on our website.
<b>Share capital</b>	<p>At 31 March 2017, the issued share capital of the company was £499,819,926 divided into 681,888,418 ordinary shares of 5 pence each and 273,956,180 deferred shares of 170 pence each. Details of our share capital and movements in our issued share capital are shown in note 22 to the financial statements on page 147. The ordinary shares represented 71.3 per cent and the deferred shares represented 28.7 per cent respectively of the shares in issue as at 31 March 2017.</p> <p>All our ordinary shares have the same rights, including the rights to one vote at any of our general meetings, to an equal proportion of any dividends we declare and pay, and to an equal amount of any surplus assets which are distributed in the event of a winding-up.</p> <p>Our deferred shares convey no right to income, no right to vote and no appreciable right to participate in any surplus capital in the event of a winding-up. The rights attaching to our shares in the company are provided by our articles of association, which may be amended or replaced by means of a special resolution of the company in general meeting. The company renews annually its power to issue and buy back shares at our AGM and such resolutions will be proposed at our 2017 AGM. Our directors' powers are conferred on them by UK legislation and by the company's articles. At the AGM of the company on 22 July 2016, the directors were authorised to issue relevant securities up to an aggregate nominal amount of £11,364,806 and were empowered to allot equity securities for cash on a non pre-emptive basis to an aggregate nominal amount of £1,704,721.</p>
<b>Voting</b>	Electronic and paper proxy appointment and voting instructions must be received by our registrars (Equiniti) not less than 48 hours before a general meeting and when calculating this period, the directors can decide not to take account of any part of a day that is not a working day.

# Directors' report

## Statutory and other information

<b>Transfers</b>	<p>There are no restrictions on the transfer of our ordinary shares in the company, nor any limitations on the holding of our shares in the company, save: (i) where the company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the company with information requested by it in accordance with Part 22 of the Companies Act 2006; or (ii) where their holder is precluded from exercising voting rights by the Financial Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers.</p> <p>There are no agreements known to us between holders of securities that may result in restrictions on the transfer of securities or on voting rights. All our issued shares are fully paid.</p>						
<b>Major shareholdings</b>	<p>At 24 May 2017, our directors had been notified of the following interests in the company's issued ordinary share capital in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority:</p> <table border="1" data-bbox="399 660 1422 728"> <thead> <tr> <th></th> <th>Per cent of issued share capital</th> <th>Direct or indirect nature of holding</th> </tr> </thead> <tbody> <tr> <td>BlackRock Inc</td> <td>5.13</td> <td>Indirect</td> </tr> </tbody> </table>		Per cent of issued share capital	Direct or indirect nature of holding	BlackRock Inc	5.13	Indirect
	Per cent of issued share capital	Direct or indirect nature of holding					
BlackRock Inc	5.13	Indirect					
<b>Purchase of own shares</b>	<p>At our last AGM held on 22 July 2016, our shareholders authorised the company to purchase, in the market, up to 68,188,841 of our ordinary shares of 5 pence each. We did not purchase any shares under this authority during the year. We normally seek such an authority from our shareholders annually. At our 2017 AGM, we will again seek authority from our shareholders to purchase up to 68,188,841 of our ordinary shares of 5 pence each with such authority expiring at the end of our AGM held in 2018.</p>						
<b>Change of control</b>	<p>As at 31 March 2017, Equiniti Trust (Jersey) Limited was the trustee that administered our executive share plans and had the ability to exercise voting rights at its discretion which related to shares that it held under the trust deed constituting the trust. In the event of a takeover offer which could lead to a change of control of the company, the trustee must consult with the company before accepting the offer or voting in favour of the offer. Subject to that requirement, the trustee may take into account a prescribed list of interests and considerations prior to making a decision in relation to the offer, including the interests of the beneficiaries under the trust.</p> <p>In the event of a change of control, the participants in our share incentive plan (ShareBuy) would be able to direct the trustee of the share incentive plan, Equiniti Share Plan Trustees Limited, how to act on their behalf.</p>						
<b>Information required by UK Listing Rule 9.8.4</b>	<p>Details of the amount of interest capitalised by the group during the financial year can be found in note 5 to the financial statements on page 137. In line with current UK tax legislation, the amount is fully deductible against the group's corporation tax liability, resulting in tax relief of £5.8 million.</p> <p>There are no other disclosures to be made under Listing Rule 9.8.4.</p>						
<b>Directors' indemnities and insurance</b>	<p>We have in place contractual entitlements for the directors of the company and of its subsidiaries to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third party indemnity provision and qualifying pension scheme indemnity provision, have been established in compliance with the relevant provisions of the Companies Act 2006 and have been in force throughout the financial year. They include provision for the company to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of the company or its subsidiaries. The company also maintains an appropriate level of directors' and officers' liability insurance.</p>						
<b>Political donations</b>	<p>We do not support any political party and do not make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the group and our political stakeholders. This includes promoting United Utilities' activities at the main political parties' annual conferences, and occasional stakeholder engagement in Westminster.</p> <p>The group incurred expenditure of £11,298 (2016: £5,360) as part of this process. At the 2016 AGM, an authority was taken to cover such expenditure. A similar resolution will be put to our shareholders at the 2017 AGM to authorise the company and its subsidiaries to make such expenditure.</p>						

<b>Trade associations</b>	We are members of a small number of trade associations. Some of these have a national focus, such as Water UK, the representative body of the UK water industry, which considers industry-wide priorities such as development of markets, customer trust, resilience, and legislation and regulation, and the Confederation of British Industry, which provides a policy making voice for firms at a regional, national and international level. Others, such as the North West Business Leadership Team and Atlantic Gateway, focus solely on North West England and encourage engagement across the public and private sectors to promote the sustainable economic development and long-term well-being of the region. Our contribution to these associations in 2016/17 was £393,000.
<b>Employees</b>	<p>Our policies on employee consultation and on equal opportunities for our disabled employees can be found in the 'People' section on page 16. The company's business principles make clear how the company and all our employees must seek to act with integrity and fairness and observe legal requirements. Anyone with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or through a confidential telephone line.</p> <p>Importance is placed on strengthening employees' engagement, measuring their views annually, then taking action to improve how they feel about the company and understand its direction. Employees are provided with regular information to enable them to understand the financial and economic factors affecting the company's performance. The board encourages employees to own shares in the company through the all employee share incentive plan (ShareBuy). For further information on our average number of employees during the year, go to note 2 on page 135.</p>
<b>Environmental, social and community matters</b>	Details of our approach to corporate responsibility, relating to the environment and social and community issues, can be found on pages 82 to 84.
<b>Essential contractual relationships</b>	Certain suppliers we use contribute key goods or services, the loss of which could cause disruption to our services. However, none are so vital that their loss would affect our viability as a group as a whole nor are we overly dependent on any one individual customer.
<b>Approach to technology development</b>	We are committed to using innovative, cost-effective and practical solutions for providing high quality services and we recognise the importance of ensuring that we focus our investment on the development of technology and that we have the right skills to apply technology to achieve sustainable competitive advantage and also that we continue to be alert to emerging technological opportunities.
<b>Financial instruments</b>	Our risk management objectives and policies in relation to the use of financial instruments can be found in note A4 to the financial statements.
<b>Events occurring after the reporting period</b>	Details of events after the reporting period are included in note 25 to the consolidated financial statements on page 148.
<b>Slavery and Human Trafficking Statement</b>	Our statement can be found on our website at: <a href="https://corporate.unitedutilities.com/slavery-human-trafficking">corporate.unitedutilities.com/slavery-human-trafficking</a>

# Directors' report

## Statutory and other information



### Annual general meeting

Our 2017 annual general meeting (AGM) will be held on 28 July.

- › Full details of the resolutions to be proposed to our shareholders, and explanatory notes in respect of these resolutions, can be found in our notice of AGM. A copy can be found on our website.



Read more online at [corporate.unitedutilities.com/annual-general-meeting-2017](http://corporate.unitedutilities.com/annual-general-meeting-2017)

At our 2017 AGM, resolutions will be proposed, amongst other matters:

- › to receive the annual report and financial statements; to approve the directors' remuneration report; to approve the directors' remuneration policy; to declare a final dividend; and to reappoint KPMG LLP as auditor;
- › to approve the directors' general authority to allot shares; to grant the authority to issue shares without first applying statutory rights of pre-emption; to authorise the company to make market purchases of its own shares; to authorise the making of limited political donations by the company and its subsidiaries; and to enable the company to continue to hold general meetings on not less than 14 working days' notice; and
- › to adopt new articles of association and to extend the life of the share incentive plan.

### Information given to the auditor

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

- › so far as he or she is aware, there is no relevant audit information of which the company's auditor is unaware; and
- › 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 s418 of the Companies Act 2006.

### Reappointment of the auditor

Our board is proposing that our shareholders reappoint KPMG LLP as our auditor at the forthcoming AGM and authorises the audit committee of the board to set the auditor's remuneration.

Approved by the board on 24 May 2017 and signed on its behalf by:

**Simon Gardiner**  
Company Secretary

# Statement of directors' responsibilities in respect of the annual report and the financial statements

The directors are responsible for preparing the annual report and the group and parent company financial statements in accordance with applicable laws and regulations.

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

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

- › select suitable accounting policies and then apply them consistently;
- › make judgements and estimates that are reasonable and prudent;
- › state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- › prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a strategic report, directors' report, directors' remuneration report and corporate governance statement that complies with that law and those regulations.

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

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

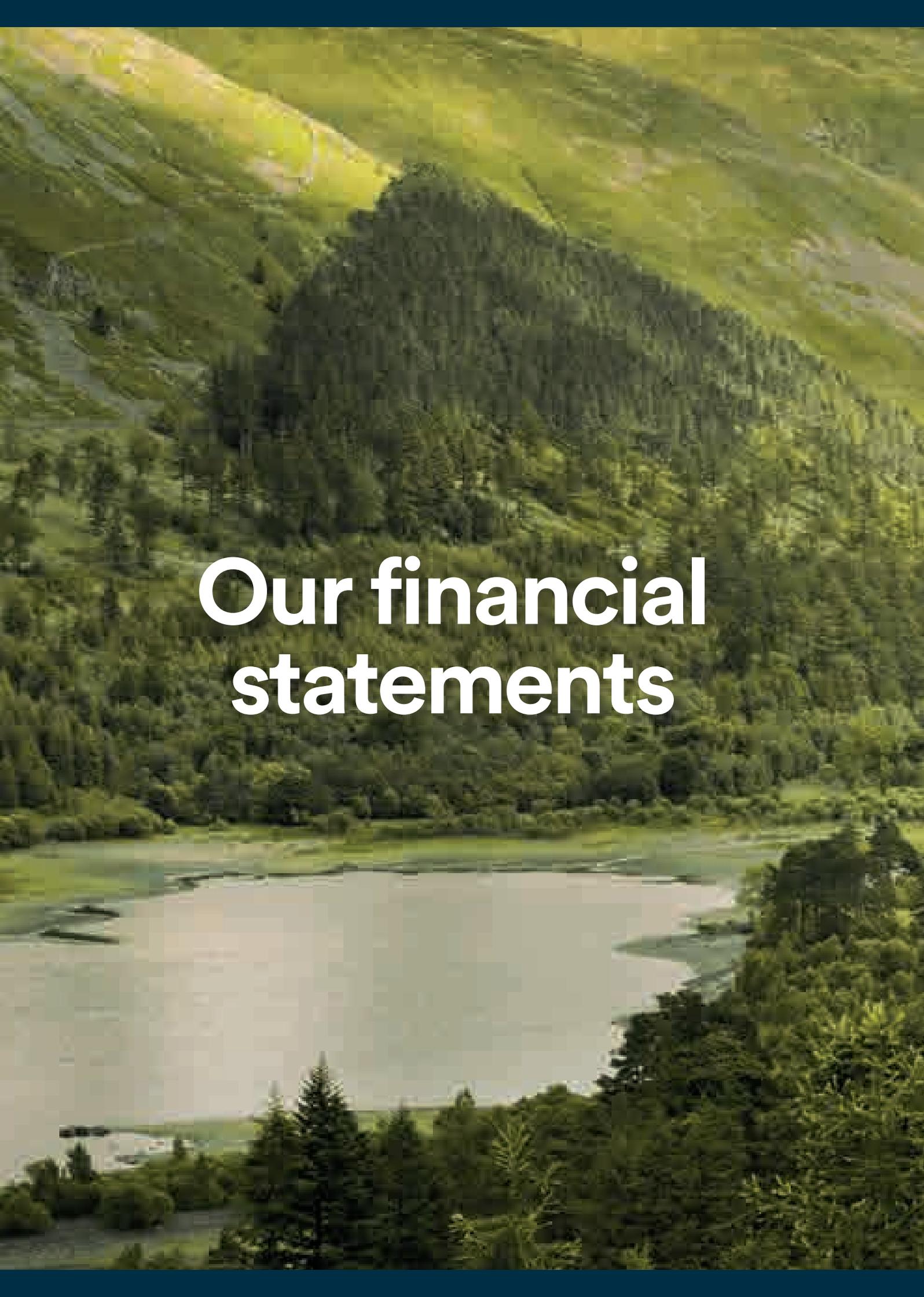
We confirm that to the best of our knowledge:

- › the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole;
- › the strategic report (contained on pages 10 to 49) includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- › the directors consider the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position, performance, business model and strategy.

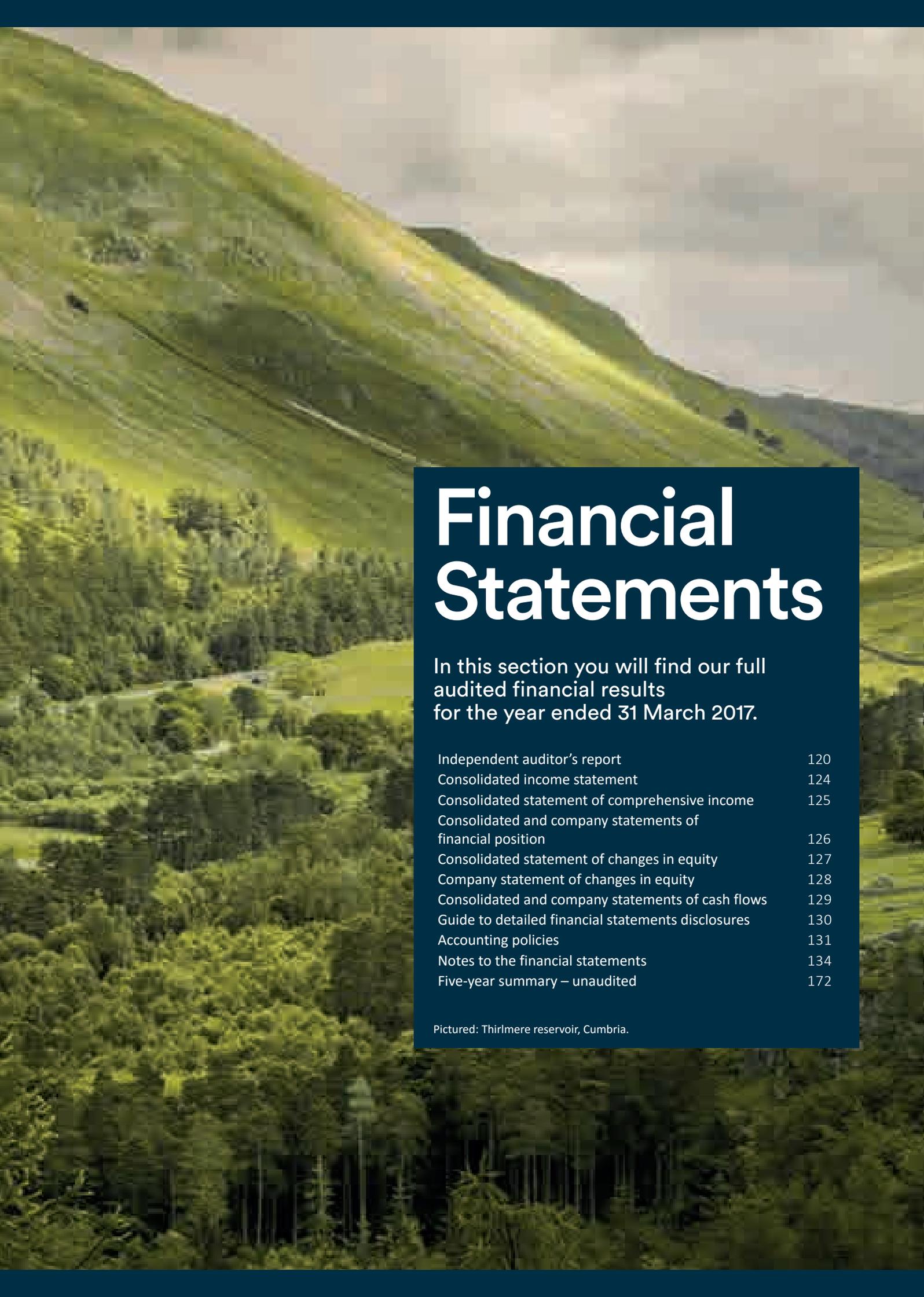
Approved by the board on 24 May 2017 and signed on its behalf by:

**Dr John McAdam**  
Chairman

**Russ Houlden**  
Chief Financial Officer



# Our financial statements



# Financial Statements

In this section you will find our full audited financial results for the year ended 31 March 2017.

Independent auditor's report	120
Consolidated income statement	124
Consolidated statement of comprehensive income	125
Consolidated and company statements of financial position	126
Consolidated statement of changes in equity	127
Company statement of changes in equity	128
Consolidated and company statements of cash flows	129
Guide to detailed financial statements disclosures	130
Accounting policies	131
Notes to the financial statements	134
Five-year summary – unaudited	172

Pictured: Thirlmere reservoir, Cumbria.

# Independent auditor's report to the members of United Utilities Group PLC only

## Opinions and conclusions arising from our audit

### 1. Our opinion on the financial statements is unmodified

We have audited the financial statements of United Utilities Group PLC for the year ended 31 March 2017 set out on pages 124 to 171. In our opinion:

- › the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2017 and of the group's profit for the year then ended;
- › the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- › the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- › the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.

Overview	
<b>Materiality</b> group financial statements as a whole	£19.5m (2016: £20.0m), 4.7% (2016: 4.9%) of normalised group profit before tax
<b>Coverage</b>	100% (2016: 100%) of normalised group profit before tax
<b>Risks of material misstatement</b>	<b>vs 2016</b>
<b>Recurring risks</b>	Revenue recognition and provision for customer debts ◀ ▶
	Capital expenditure ◀ ▶
	Retirement benefit surplus ◀ ▶

### 2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as set out below. We no longer consider derivative financial instrument valuations to be a significant risk of material misstatement on the basis that the valuations performed are mechanistic in nature and, although they are cumulatively a large balance, the risk of an error within the balance is relatively low.

The risk	Our response
<p><b>Revenue recognition and provision for customer debts</b></p> <p>Revenue: £1,704.0 million (2016: £1,730.0 million)</p> <p>Provision for customer debts: £85.4 million (2016: £94.4 million)</p> <p>Refer to page 79 (Audit Committee report), pages 131 and 165 (accounting policy), and pages 134 and 143 (financial disclosures).</p>	<p>Our procedures included:</p> <p><b>Accounting analysis</b> – comparison of policy with relevant accounting standards and industry practice, including the policy of not recognising revenue where it is not probable that cash will be received. Then through observation of processes assessing whether the revenue recognition policies have been applied in practice;</p> <p><b>Control observation</b> – testing the group's controls over revenue recognition and provision for customer debts, including reconciliations between sales and cash receipts systems and the general ledger;</p> <p><b>Methodology choice</b> – assessing the appropriateness of the customer debt provisioning based on historical cash collections, credits, re-bills and write-off information;</p> <p><b>Tests of details</b> – assessing the assumptions used to calculate the metered accrued income by considering whether inputs to the calculation have been derived appropriately and recalculating the accrued income with the support of our own modelling specialists; and</p> <p><b>Assessing transparency</b> – assessing the adequacy of the group's disclosures of its revenue recognition and customer debt provisioning policies, including the estimation uncertainty involved in recording revenue and the bad debt provision.</p>
<p><b>Subjective estimation:</b></p> <p>A proportion of the group's customers do not, or cannot, pay their bills, which results in the need for provisions to be made for non-payment of the customer balance. Due to the level of judgement and complexity of the calculation, which could lead to revenue and provision for customer debt being misstated, this is considered a key audit risk.</p> <p>Significant judgement is required when recognising revenue for services that are billed that relate to properties where either the occupier cannot be identified or where a past history of non-payment of bills exists and therefore there is uncertainty over the probability of these bills being settled.</p> <p>Further, an estimate is required of revenue for the value of water supplied to metered customers between the last meter reading and the period end.</p>	

	The risk	Our response
<p><b>Capital expenditure</b></p> <p>£717.9 million (2016: £665.8 million)</p> <p>Refer to page 79 (Audit Committee report), pages 131 to 132 and 166 (accounting policy), and page 140 (financial disclosures).</p>	<p><b>Accounting treatment:</b></p> <p>The group has a substantial capital programme which has been agreed with the Water Services Regulation Authority (Ofwat) and therefore incurs significant annual expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets.</p> <p>The determination of project costs as capital or operating expenditure is inherently judgemental as there is a need to distinguish between enhancement and maintenance works. Costs capitalised include an allocation of overhead costs, relating to the proportion of time spent by support function staff, which is also inherently judgemental.</p>	<p>Our procedures included:</p> <p><b>Accounting analysis</b> – assessing the group’s capitalisation policy for compliance with relevant accounting standards;</p> <p><b>Control observation</b> – testing controls over the application of the policy in the period including assessment of project business case submissions and attending capital approval meetings to observe the judgements made and evaluating the documented conclusions;</p> <p><b>Tests of details</b> – critically assessing the costs capitalised for a sample of projects against the capitalisation policy;</p> <p><b>Tests of details</b> – identify and assess the impact of in-year changes to capitalisation rates and for all existing projects, as once set they are typically unchanged period to period;</p> <p><b>Historical comparisons</b> – critically assess the proportion of overhead costs by business area which are capitalised using historical comparisons and expected changes based on corroborated enquiry and our sector knowledge; and</p> <p><b>Assessing transparency</b> – assessing the adequacy of the group’s disclosures of its capitalisation policy and other related disclosures.</p>
<p><b>Retirement benefit surplus</b></p> <p>£247.5 million (2016: £275.2 million)</p> <p>Refer to page 79 (Audit Committee report), pages 132 and 168 (accounting policy), and pages 145 and 159 to 163 (financial disclosures).</p>	<p><b>Subjective estimation:</b></p> <p>Significant estimates are made in valuing the group’s retirement benefit obligation. Small changes in assumptions and estimates used to value the group’s pension obligation would have a significant effect on the group’s financial position.</p>	<p>Our procedures included:</p> <p><b>Benchmarking assumptions</b> – challenging the key assumptions supporting the group’s retirement benefit obligations valuation with input from our own actuarial specialists, including comparing the discount rate, inflation rate, salary, pension increase rates and life expectancy assumptions used against externally derived data; and</p> <p><b>Assessing transparency</b> – assessing the group’s disclosure in respect of the sensitivity of the surplus to changes in the key assumptions.</p>

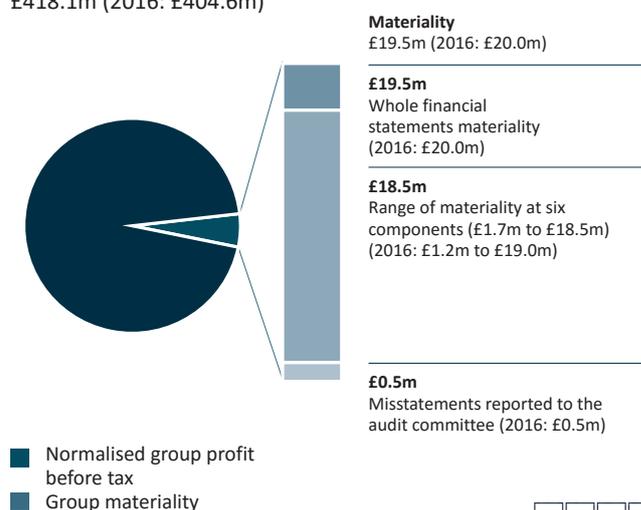
### 3. Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £19.5 million (2016: £20.0 million), determined with reference to a benchmark of group profit before tax, normalised to exclude net fair value losses on debt and derivative instruments (see note 5). Materiality represents 4.7 per cent (2016: 4.9 per cent) of normalised group profit before tax. Specific audit procedures have been performed over items excluded from the normalised profit before tax.

We report to the audit committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2016: £0.5 million), in addition to other identified misstatements that warrant reporting on qualitative grounds.

#### Normalised group profit before tax

£418.1m (2016: £404.6m)



# Independent auditor's report to the members of United Utilities Group PLC only

Of the group's six (2016: six) reporting components, we subjected six (2016: five) to audit, of which the most significant is United Utilities Water Limited, which makes up the vast majority of the assets, liabilities, income and expense of the group. These components covered 99 per cent of group revenue (2016: 99 per cent), 100 per cent of group profit before tax (2016: 100 per cent), 100 per cent of group normalised profit before tax (2016: 100 per cent), and 97 per cent of group total assets (2016: 100 per cent).

The group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The group team approved the component materialities, which ranged from £1.7 million to £18.5 million (2016: £1.2 million to £19.0 million), having regard to the mix of size and risk profile of the group across the components. The work on one of the six components (2016: none of the six components) was performed by component auditors and the rest by the group team. The group team performed procedures on the items excluded from normalised group profit before tax.

The group team visited the component location in Stoke. Telephone conference meetings were also held with these component auditors. At these meetings the findings reported to the group team were discussed in more details and any further work required by the group team was then performed by the component auditor.

## 4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

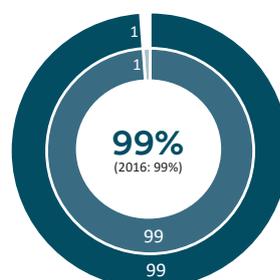
In our opinion:

- › the part of the Directors' Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;
- › the information given in the Strategic report and the Directors' report for the financial year is consistent with the financial statements.

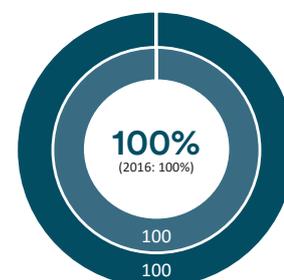
Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- › we have not identified material misstatements in these reports; and
- › in our opinion those reports have been prepared in accordance with the Companies Act 2006.

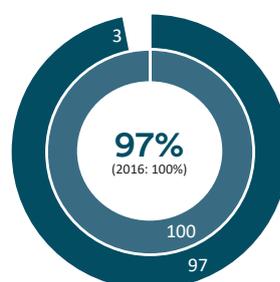
### Group revenue



### Group normalised profit before tax



### Group total assets



- Full scope for group audit purposes 2017
- Residual components 2017
- Full scope for group audit purposes 2016
- Residual components 2016

## 5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- › the directors' statement of long-term viability on page 73, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the group's continuing in operation over the five years to March 2022; or
- › the disclosures in the accounting policies section concerning the use of the going concern basis of accounting.

## 6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- › we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy; or
- › the audit committee section of the Corporate Governance report does not appropriately address matters communicated by us to the audit committee.

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

- › adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- › the parent company financial statements and the part of the Directors' Remuneration report to be audited 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.

Under the Listing Rules we are required to review:

- › the directors' statements, set out on page 73 and 131, in relation to going concern and longer-term viability; and
- › the part of the Corporate Governance Statement on page 57 relating to the company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

## Scope and responsibilities

As explained more fully in the Statement of directors' responsibilities set out on page 117, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. 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](http://www.frc.org.uk/auditscopeukprivate). This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at [www.kpmg.com/uk/auditscopeukco2014a](http://www.kpmg.com/uk/auditscopeukco2014a), which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

**William Meredith (Senior Statutory Auditor)**  
**for and on behalf of KPMG LLP, Statutory Auditor**  
 Chartered Accountants  
 St Peter's Square, Manchester, M2 3AE  
 24 May 2017

# Consolidated income statement for the year ended 31 March

	Note	2017 £m	2016 £m
<b>Revenue</b>	1	<b>1,704.0</b>	1,730.0
Employee benefits expense	2	(151.9)	(146.9)
Other operating costs	3	(435.1)	(485.8)
Other income	3	4.2	3.6
Depreciation and amortisation expense	3	(364.9)	(363.7)
Infrastructure renewals expenditure		(150.8)	(169.3)
<b>Total operating expenses</b>		<b>(1,098.5)</b>	(1,162.1)
<b>Operating profit</b>		<b>605.5</b>	567.9
Investment income	4	13.7	5.0
Finance expense	5	(202.7)	(224.4)
<b>Investment income and finance expense</b>		<b>(189.0)</b>	(219.4)
Profit on disposal of business	9	22.1	–
Share of profits of joint ventures		3.8	5.0
<b>Profit before tax</b>		<b>442.4</b>	353.5
Current tax charge	6	(31.5)	(44.3)
Deferred tax charge	6	(35.2)	(24.2)
Deferred tax credit – change in tax rate	6	58.2	112.5
<b>Tax</b>	6	<b>(8.5)</b>	44.0
<b>Profit after tax</b>		<b>433.9</b>	397.5
<b>Earnings per share</b>			
Basic	7	<b>63.6p</b>	58.3p
Diluted	7	<b>63.5p</b>	58.2p
Dividend per ordinary share	8	<b>38.87p</b>	38.45p

All of the results shown above relate to continuing operations.

## Consolidated statement of comprehensive income for the year ended 31 March

	Note	2017 £m	2016 £m
<b>Profit after tax</b>		<b>433.9</b>	397.5
<b>Other comprehensive income</b>			
Remeasurement (losses)/gains on defined benefit pension schemes	18	(76.7)	160.1
Tax on items taken directly to equity	6	17.3	(26.5)
Foreign exchange adjustments		3.7	3.0
<b>Total comprehensive income</b>		<b>378.2</b>	534.1

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

# Consolidated and company statements of financial position at 31 March

		Group		Company	
	Note	2017 £m	2016 £m	2017 £m	2016 £m
<b>ASSETS</b>					
<b>Non-current assets</b>					
Property, plant and equipment	10	10,405.5	10,031.4	–	–
Intangible assets	11	187.7	162.4	–	–
Interests in joint ventures	12	75.2	35.1	–	–
Investments	13	9.0	8.7	6,326.8	6,326.8
Trade and other receivables	15	112.3	2.5	–	–
Retirement benefit surplus	18	247.5	275.2	–	–
Derivative financial instruments	A4	731.0	765.5	–	–
		<b>11,768.2</b>	11,280.8	<b>6,326.8</b>	6,326.8
<b>Current assets</b>					
Inventories	14	22.4	29.3	–	–
Trade and other receivables	15	303.9	367.4	69.0	62.5
Current tax asset		7.1	–	–	–
Cash and short-term deposits	16	247.8	213.6	–	–
Derivative financial instruments	A4	76.7	0.1	–	–
Assets classified as held for sale	9	–	15.6	–	–
		<b>657.9</b>	626.0	<b>69.0</b>	62.5
<b>Total assets</b>		<b>12,426.1</b>	11,906.8	<b>6,395.8</b>	6,389.3
<b>LIABILITIES</b>					
<b>Non-current liabilities</b>					
Trade and other payables	21	(589.3)	(530.5)	–	–
Borrowings	17	(7,058.4)	(6,508.8)	(1,665.4)	(1,636.9)
Deferred tax liabilities	19	(1,031.5)	(1,062.0)	–	–
Derivative financial instruments	A4	(235.5)	(255.8)	–	–
		<b>(8,914.7)</b>	(8,357.1)	<b>(1,665.4)</b>	(1,636.9)
<b>Current liabilities</b>					
Trade and other payables	21	(323.0)	(341.7)	(10.3)	(11.1)
Borrowings	17	(326.1)	(469.2)	(0.6)	(0.5)
Current tax liabilities		–	(12.3)	–	–
Provisions	20	(26.5)	(15.1)	–	–
Derivative financial instruments	A4	(14.2)	(5.9)	–	–
		<b>(689.8)</b>	(844.2)	<b>(10.9)</b>	(11.6)
<b>Total liabilities</b>		<b>(9,604.5)</b>	(9,201.3)	<b>(1,676.3)</b>	(1,648.5)
<b>Total net assets</b>		<b>2,821.6</b>	2,705.5	<b>4,719.5</b>	4,740.8
<b>EQUITY</b>					
<b>Capital and reserves attributable to equity holders of the company</b>					
Share capital	22	499.8	499.8	499.8	499.8
Share premium account		2.9	2.9	2.9	2.9
Cumulative exchange reserve		(2.0)	(5.7)	–	–
Capital redemption reserve		–	–	1,033.3	1,033.3
Merger reserve		329.7	329.7	–	–
Retained earnings		1,991.2	1,878.8	3,183.5	3,204.8
<b>Shareholders' equity</b>		<b>2,821.6</b>	2,705.5	<b>4,719.5</b>	4,740.8

These financial statements for the group and United Utilities Group PLC (company number: 6559020) were approved by the board of directors on 24 May 2017 and signed on its behalf by:

**Steve Mogford**  
Chief Executive Officer

**Russ Houlden**  
Chief Financial Officer

# Consolidated statement of changes in equity for the year ended 31 March

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2016	499.8	2.9	(5.7)	329.7	1,878.8	2,705.5
Profit after tax	–	–	–	–	433.9	433.9
<b>Other comprehensive (expense)/income</b>						
Remeasurement losses on defined benefit pension schemes (see note 18)	–	–	–	–	(76.7)	(76.7)
Tax on items taken directly to equity (see note 6)	–	–	–	–	17.3	17.3
Foreign exchange adjustments	–	–	3.7	–	–	3.7
<b>Total comprehensive income</b>	–	–	3.7	–	374.5	378.2
Dividends (see note 8)	–	–	–	–	(263.1)	(263.1)
Equity-settled share-based payments (see note 2)	–	–	–	–	3.4	3.4
Exercise of share options – purchase of shares	–	–	–	–	(2.4)	(2.4)
<b>At 31 March 2017</b>	<b>499.8</b>	<b>2.9</b>	<b>(2.0)</b>	<b>329.7</b>	<b>1,991.2</b>	<b>2,821.6</b>

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2015	499.8	2.9	(8.7)	329.7	1,610.7	2,434.4
Profit after tax	–	–	–	–	397.5	397.5
<b>Other comprehensive (expense)/income</b>						
Remeasurement gains on defined benefit pension schemes (see note 18)	–	–	–	–	160.1	160.1
Tax on items taken directly to equity (see note 6)	–	–	–	–	(26.5)	(26.5)
Foreign exchange adjustments	–	–	3.0	–	–	3.0
<b>Total comprehensive income</b>	–	–	3.0	–	531.1	534.1
Dividends (see note 8)	–	–	–	–	(258.7)	(258.7)
Equity-settled share-based payments (see note 2)	–	–	–	–	2.3	2.3
Exercise of share options – purchase of shares	–	–	–	–	(6.6)	(6.6)
At 31 March 2016	499.8	2.9	(5.7)	329.7	1,878.8	2,705.5

The merger reserve arose in the year ended 31 March 2009 on consolidation and represents the capital adjustment to reserves required to effect the reverse acquisition of United Utilities PLC by United Utilities Group PLC.

## Company statement of changes in equity for the year ended 31 March

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2016	499.8	2.9	1,033.3	3,204.8	4,740.8
Profit after tax	–	–	–	240.8	240.8
<b>Total comprehensive income</b>	–	–	–	240.8	240.8
Dividends (see note 8)	–	–	–	(263.1)	(263.1)
Equity-settled share-based payments (see note 2)	–	–	–	3.4	3.4
Exercise of share options – purchase of shares	–	–	–	(2.4)	(2.4)
<b>At 31 March 2017</b>	<b>499.8</b>	<b>2.9</b>	<b>1,033.3</b>	<b>3,183.5</b>	<b>4,719.5</b>

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2015	499.8	2.9	1,033.3	3,231.4	4,767.4
Profit after tax	–	–	–	236.4	236.4
<b>Total comprehensive income</b>	–	–	–	236.4	236.4
Dividends (see note 8)	–	–	–	(258.7)	(258.7)
Equity-settled share-based payments (see note 2)	–	–	–	2.3	2.3
Exercise of share options – purchase of shares	–	–	–	(6.6)	(6.6)
At 31 March 2016	499.8	2.9	1,033.3	3,204.8	4,740.8

The capital redemption reserve arose as a result of a return of capital to shareholders following the reverse acquisition of United Utilities PLC by United Utilities Group PLC in the year ended 31 March 2009.

As permitted by section 408 of the Companies Act 2006, the company has not presented its own income statement. The result of the company for the financial year was a profit after tax of £240.8 million (2016: £236.4 million).

# Consolidated and company statements of cash flows for the year ended 31 March

	Note	Group		Company	
		2017 £m	2016 £m	2017 £m	2016 £m
<b>Operating activities</b>					
Cash generated from operations	A1	1,018.1	905.5	265.4	261.3
Interest paid		(161.0)	(168.7)	(28.5)	(27.5)
Interest received and similar income		4.9	1.9	–	–
Tax paid		(42.4)	(53.1)	–	–
Tax received		1.2	–	5.5	5.5
<b>Net cash generated from operating activities</b>		<b>820.8</b>	<b>685.6</b>	<b>242.4</b>	<b>239.3</b>
<b>Investing activities</b>					
Purchase of property, plant and equipment		(672.4)	(634.2)	–	–
Purchase of intangible assets		(52.4)	(66.1)	–	–
Proceeds from sale of property, plant and equipment		4.1	1.4	–	–
Grants and contributions received	21	29.0	17.3	–	–
Loans to joint ventures	A6	(109.0)	–	–	–
Investment in joint ventures	12	(13.5)	–	–	–
Proceeds from disposal of business	9	3.3	–	–	–
Dividends received from joint ventures		5.4	4.6	–	–
Proceeds from investments	13	0.9	0.2	–	–
<b>Net cash used in investing activities</b>		<b>(804.6)</b>	<b>(676.8)</b>	<b>–</b>	<b>–</b>
<b>Financing activities</b>					
Proceeds from borrowings		736.2	693.0	23.0	25.9
Repayment of borrowings		(448.7)	(474.1)	–	–
Dividends paid to equity holders of the company	8	(263.1)	(258.7)	(263.1)	(258.7)
Exercise of share options – purchase of shares		(2.4)	(6.6)	(2.4)	(6.6)
<b>Net cash generated from/(used in) financing activities</b>		<b>22.0</b>	<b>(46.4)</b>	<b>(242.5)</b>	<b>(239.4)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>38.2</b>	<b>(37.6)</b>	<b>(0.1)</b>	<b>(0.1)</b>
Cash and cash equivalents at beginning of the year		182.1	219.7	(0.5)	(0.4)
<b>Cash and cash equivalents at end of the year</b>	16	<b>220.3</b>	<b>182.1</b>	<b>(0.6)</b>	<b>(0.5)</b>

# Guide to detailed financial statements disclosures

In the interest of providing clear and relevant information to the users of our financial statements we have included summary information within notes to the financial statements, with additional detailed information included in appendices where required. These notes and appendices can be grouped as follows:

Notes and appendices	Page	Notes and appendices	Page		
<i>Operations – information relating to our operating results</i>					
1	Revenue and segment reporting	134	23	Operating lease commitments	148
2	Directors and employees	134	A1	Cash generated from operations	149
3	Operating profit	135			
<i>Financing – information relating to how we finance our business</i>					
4	Investment income	136	17	Borrowings	144
5	Finance expense	137	22	Share capital	147
7	Earnings per share	139	A2	Net debt	149
8	Dividends	139	A3	Borrowings	150
16	Cash and cash equivalents	144	A4	Financial risk management	152
<i>Working capital – information relating to the day-to-day working capital of our business</i>					
14	Inventories	142	21	Trade and other payables	147
15	Trade and other receivables	143	A6	Related party transactions	163
16	Cash and cash equivalents	144			
<i>Tax – information relating to our current and deferred taxation</i>					
6	Tax	138	19	Deferred tax liabilities	146
<i>Employees – information relating to the costs associated with employing our people</i>					
2	Directors and employees	134	A5	Retirement benefits	159
18	Retirement benefits	145			
<i>Long-term assets – information relating to our long-term operational and investment assets</i>					
10	Property, plant and equipment	140	13	Investments	142
11	Intangible assets	141	18	Retirement benefits	145
12	Joint ventures	141	A5	Retirement benefits	159
<i>Other – other useful information</i>					
9	Disposal of non-household retail business	139	25	Events after the reporting period	148
20	Provisions	146	A7	Accounting policies	165
24	Contingent liabilities	148	A8	Subsidiaries and other group undertakings	170

# Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. Further detail can be found in note A7.

## Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). They have been prepared on the historical cost basis, except for the revaluation of financial instruments, accounting for the transfer of assets from customers and the revaluation of infrastructure assets to fair value on transition to IFRS.

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

The financial statements have been prepared on the going concern basis as the directors have a reasonable expectation that the group has adequate resources for a period of at least 12 months from the date of the approval of the financial statements, and that there are no material uncertainties to disclose.

In assessing the appropriateness of the going concern basis of accounting, the directors have reviewed the resources available to the group, taking account of the group's financial projections, together with available cash and committed borrowing facilities as well as consideration of the group's capital adequacy, consideration of the primary legal duty of United Utilities Water Limited's (UUW) economic regulator to ensure that water and wastewater companies can finance their functions, and any material uncertainties. The board has also considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of mitigating actions that the directors would consider undertaking.

## Adoption of new and revised standards

The following standards, interpretations and amendments, effective for the year ended 31 March 2017, have had no material impact on the group's financial statements:

- › Amendments to IAS 1 'Disclosure initiative', in respect of improved financial statement disclosures;
- › Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations', requiring business combination accounting to be applied; and
- › Improvements to IFRS (2014), comprising a collection of narrow-scope amendments across a number of standards.

## Critical accounting judgements and key sources of estimation uncertainty

In the process of applying its accounting policies set out in note A7, the group is required to make certain estimates, judgements and assumptions that it believes are reasonable based on

the information available. These judgements, estimates and assumptions affect the amounts of assets and liabilities at the date of the financial statements and the amounts of revenues and expenses recognised during the reporting periods presented. Changes to these estimates, judgements and assumptions could have a material effect on the financial statements.

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

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

### *Revenue recognition and allowance for doubtful receivables*

**Accounting judgement** – the group recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. When the group considers that the criteria for revenue recognition are not met for a transaction, revenue recognition is delayed until such time as collectability is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

**Accounting estimate** – at each reporting date, the company and each of its subsidiaries evaluate the estimated recoverability of trade receivables and record allowances for doubtful receivables based on experience. Judgements associated with these allowances are based on, amongst other things, a consideration of actual collection history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

**Accounting estimate** – UUW raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the receivable billed is dependent on the volume supplied including the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing through to each reporting date. The estimated usage is based on historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to the estimates is determined. For customers who do not have a meter, the receivable billed and revenue recognised is dependent on the rateable value of the property, as assessed by an independent rating officer.

### *Property, plant and equipment*

**Accounting judgement** – the group recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure requires an accounting judgement, particularly when projects have both

# Accounting policies

elements within them. In addition, management capitalises time and resources incurred by the group's support functions on capital programmes, which requires accounting judgements to be made in relation to the appropriate capitalisation rates.

**Accounting estimate** – the estimated useful economic lives of PPE is based on management's experience. When management identifies that actual useful economic lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of PPE investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively and, as such, this is a key source of estimation uncertainty, although historically few changes to estimated useful economic lives have been required.

**Accounting estimate** – the group is required to evaluate the carrying values of PPE for impairment whenever circumstances indicate, in management's view, that the carrying value of such assets may not be recoverable. An impairment review requires management to make uncertain estimates concerning the cash flows, growth rates and discount rates of the cash generating units under review.

## **Retirement benefits**

**Accounting estimate** – the group operates two defined benefit schemes which are independent of the group's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary, which are used to estimate the present value of defined benefit obligations. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note A5.

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

## **Tax**

**Accounting judgement** – assessing the outcome of uncertain tax positions requires judgements to be made regarding the application of tax law and the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions.

## **Derivative financial instruments**

**Accounting estimate** – the model used to fair value the group's derivative financial instruments requires management to estimate future cash flows based on applicable interest rate curves. Projected cash flows are then discounted back using discount factors which are derived from the applicable interest rate curves adjusted for management's estimate of counterparty and own credit risk, where appropriate.

## **Provisions and contingencies**

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

**Accounting estimates** – reasonable estimates are made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 24, unless the possibility of transferring economic benefits is remote.

## **New and revised standards not yet effective**

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

### **IFRS 9 'Financial Instruments'**

The standard is effective for periods commencing on or after 1 January 2018. Under the provisions of this standard, where the group has chosen to measure borrowings at fair value through profit or loss, the portion of the change in fair value due to changes in the group's own credit risk will be recognised in other comprehensive income rather than within profit or loss. If this standard had been adopted in the current year, an £11.9 million loss would have been recognised in other comprehensive income rather than within the income statement.

The standard also broadens the scope of what can be included within a hedge relationship, which may enable the group's regulatory swaps to be designated within cash flow hedge relationships. If the standard had been adopted in the current year, with all such swaps being designated and all hedges being fully effective, £0.8 million of fair value losses would have been recognised in other comprehensive income rather than within the income statement.

In addition, the standard requires entities to use an expected credit loss model for impairment of financial assets instead of an incurred credit loss model. This is expected to impact the way in which the group provides for bad and doubtful receivables. Work in this area is ongoing and it is not currently possible to quantify the expected impact as this will be dependent on the design of the model and the economic circumstances at the point of implementation; however, the current expectation is that it is unlikely to have a material impact on the overall level of provisions.

***IFRS 15 'Revenue from Contracts with Customers'***

The standard is effective for periods commencing on or after 1 January 2018. This standard introduces a new revenue recognition model and replaces IAS 18 'Revenue', IAS 11 'Construction Contracts', IFRIC 13 'Customer Loyalty Programmes', IFRIC 15 'Agreements for the Construction of Real Estate', IFRIC 18 'Transfer of Assets from Customers' and SIC-31 'Revenue – Barter Transactions Involving Advertising Services'. While the introduction of IFRS 15 is expected to have a significant impact for many companies, the directors have carefully considered the potential effects in the context of the group's revenues and have concluded that on adoption there will be no significant changes to the way in which the group's performance obligations to customers are identified or deemed to be satisfied and, therefore, no material impact on the revenues recognised in the financial statements.

***IFRS 16 'Leases'***

The standard is effective for periods commencing on or after 1 January 2019 but has not yet been endorsed by the EU. Under the provisions of the standard most leases, including the majority of those previously classified as operating leases, will be brought onto the statement of financial position, as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 'Property, Plant and Equipment' and the liability increased for the accretion of interest and reduced by lease payments.

If the standard had been adopted in the current year a depreciation charge of around £4 million in relation to the right-of-use asset and a finance expense charge of around £1 million would have been recognised in the income statement in place of the operating lease charge of £4.4 million. In addition, a right-of-use asset and largely offsetting lease liability of around £105 million would be recognised in the statement of financial position, assuming application of the modified retrospective transitional approach as permitted by the standard and current incremental costs of borrowing. The actual impact on adoption will be sensitive to the incremental costs of borrowing at the 1 April 2019 application date.

All other standards, interpretations and amendments, which are in issue but not yet effective, are not expected to have a material impact on the group's financial statements.

# Notes to the financial statements

## 1 Revenue and segment reporting

The group's revenue predominantly arises from the provision of services within the United Kingdom, with less than one per cent of external revenue and non-current assets being overseas.

The group has a large and diverse domestic retail customer base with no significant reliance on any single customer in this area. Following the sale of the group's non-household business on 1 June 2016 (see note 9), £402.7 million (2016: £nil) of the group's revenue from wholesale water and wastewater services during the year was derived from sales to Water Plus Group Limited (Water Plus), a joint venture formed during the year between United Utilities PLC and Severn Trent PLC, and its subsidiaries. Please see notes A4 and A6 for further details.

The board of directors of United Utilities Group PLC (the board) is provided with information on a single segment basis for the purposes of assessing performance and allocating resources. The board reviews revenue, underlying operating profit (see page 45), operating profit, assets and liabilities, regulatory capital expenditure and regulatory capital value (RCV) gearing at a consolidated level. In light of this, the group has a single segment for financial reporting purposes and therefore no further detailed segmental information is provided in this note.

## 2 Directors and employees

### Directors' remuneration

	2017 £m	2016 £m
Fees to non-executive directors	0.7	0.6
Salaries	1.2	1.2
Benefits	0.3	0.3
Bonus	0.6	0.4
Share-based payment charge	1.5	1.0
	<b>4.3</b>	<b>3.5</b>

Further information about the remuneration of individual directors and details of their pension arrangements are provided in the directors' remuneration report on pages 86 to 109.

### Remuneration of key management personnel

	2017 £m	2016 £m
Salaries and short-term employee benefits	5.5	4.9
Post-employment benefits	0.1	0.1
Share-based payment charge	2.6	1.8
	<b>8.2</b>	<b>6.8</b>

Key management personnel comprises all directors and certain senior managers who are members of the executive team.

### Employee benefits expense (including directors)

<b>Group</b>	2017 £m	2016 £m
Wages and salaries	219.9	212.7
Social security	21.7	19.1
Severance	7.0	(0.2)
Post-employment benefits:		
Defined benefit pension expense (see note 18)	25.5	26.1
Defined contribution pension expense (see note 18)	11.2	9.9
	<b>36.7</b>	<b>36.0</b>
Charged to regulatory capital schemes	(129.4)	(120.7)
Amounts recharged to related parties at nil margin under transitional service agreements (see note A5)	(4.0)	–
<b>Employee benefits expense</b>	<b>151.9</b>	<b>146.9</b>

Within employee benefits expense were £10.1 million (2016: £0.9 million) of restructuring costs.

## 2 Directors and employees continued

The total expense included within employee benefits expense in respect of equity-settled share-based payments was £3.4 million (2016: £2.3 million). The company operates several share option schemes, details of which are given on pages 101 to 103 in the directors' remuneration report. Further disclosures have not been included as they are considered immaterial to the assessment of the share-based payments charge.

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

	2017 number	2016 number
Average number of employees during the year	5,310	5,265

### Company

The company has no employees.

## 3 Operating profit

The following items have been charged/(credited) to the income statement in arriving at the group's operating profit:

	2017 £m	2016 £m
<b>Other operating costs</b>		
Hired and contracted services	101.5	107.5
Property rates	91.6	86.3
Power	68.7	65.3
Materials	67.7	67.2
Charge for bad and doubtful receivables (see note 15)	29.9	39.2
Regulatory fees	28.6	27.9
Cost of properties disposed	8.6	10.5
Legal and professional expenses	6.5	5.8
Operating leases payable:		
Property	3.8	4.2
Plant and equipment	0.6	0.8
Loss on disposal of property, plant and equipment	3.3	5.4
Third party wholesale charges	3.0	15.1
Impairment of property, plant and equipment (see note 10)	0.2	11.4
Impairment of assets classified as held for sale	–	2.7
Amortisation of deferred grants and contributions (see note 21)	(6.7)	(6.9)
Compensation from insurers	(12.3)	(20.1)
Other expenses	40.1	63.5
	<b>435.1</b>	<b>485.8</b>
<b>Other income</b>		
Other income	(4.2)	(3.6)
	<b>(4.2)</b>	<b>(3.6)</b>
<b>Depreciation and amortisation expense</b>		
Depreciation of property, plant and equipment (see note 10)	336.2	332.5
Amortisation of intangible assets (see note 11)	28.7	31.2
	<b>364.9</b>	<b>363.7</b>

# Notes to the financial statements

## 3 Operating profit continued

As a result of two significant flooding incidents caused by storms Desmond and Eva in December 2015, there were £13.8 million (2016: £19.5 million) of expenses incurred, comprising £11.1 million (2016: £7.0 million) of operating costs, £2.5 million (2016: £1.1 million) of infrastructure renewals expenditure, and a £0.2 million (2016: £11.4 million) impairment of property, plant and equipment. Insurance compensation of £12.3 million (2016: £20.1 million) relating to the flooding incidents has been recognised and the group expects there to be further recovery of flooding incident costs under its insurance cover in the year ending 31 March 2018, as further remedial work is undertaken.

In addition, there were £5.8 million (2016: £11.1 million) of market reform restructuring costs incurred in preparing the business for competition in the non-household retail market and £nil (2016: £24.8 million) of costs relating to a large water quality incident in the prior year, largely comprising customer compensation payments included within other expenses.

Total other operating costs are stated net of £14.5 million (2016: £nil) of costs recharged to Water Plus at nil margin under transitional service agreements.

Research and development expenditure for the year ended 31 March 2017 was £2.3 million (2016: £2.3 million).

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

	2017 £'000	Re-presented* 2016 £'000
<b>Audit services</b>		
Statutory audit – group and company	72	70
Statutory audit – subsidiaries	278	239
	<b>350</b>	309
<b>Non-audit-services</b>		
Regulatory audit services provided by the statutory auditor	53	45
Other non-audit services	201	288
	<b>604</b>	642

\* Prior year comparatives in the above table have been re-presented to reflect the classification of services provided by the auditor that will be adopted prospectively in accordance with the group audit committee's policy in relation to this area, further details of which can be found within the corporate governance report on page 77.

## 4 Investment income

	2017 £m	2016 £m
Interest receivable on short-term bank deposits held at amortised cost	0.9	1.9
Interest receivable on loans to joint ventures held at amortised cost (see note A6)	2.6	–
Net pension interest income (see note 18)	10.2	3.1
	<b>13.7</b>	5.0

## 5 Finance expense

	2017 £m	2016 £m
<b>Interest payable</b>		
Interest payable on borrowings held at amortised cost <sup>(1)</sup>	227.0	198.1
	<b>227.0</b>	198.1
<b>Fair value (gains)/losses on debt and derivative instruments<sup>(2)</sup></b>		
Fair value hedge relationships:		
Borrowings	70.4	60.8
Designated swaps	(81.4)	(62.2)
	<b>(11.0)</b>	(1.4)
Financial instruments at fair value through profit or loss:		
Borrowings designated at fair value through profit or loss <sup>(3)</sup>	37.5	4.3
Associated swaps <sup>(4)</sup>	(30.1)	(23.5)
	<b>7.4</b>	(19.2)
Fixed interest rate swaps <sup>(4)</sup>	0.8	46.2
Electricity swaps <sup>(4)</sup>	(9.6)	14.2
Net receipts on swaps and debt under fair value option	(14.4)	(16.1)
Other swaps <sup>(4)(5)</sup>	(5.0)	(3.0)
Other	7.5	5.6
	<b>(20.7)</b>	46.9
<b>Net fair value (gains)/losses on debt and derivative instruments<sup>(6)</sup></b>	<b>(24.3)</b>	26.3
	<b>202.7</b>	224.4

### Notes:

- (1) Includes an £80.7 million (2016: £37.9 million) non-cash inflation uplift expense in relation to the group's index-linked debt.
- (2) Includes foreign exchange losses of £119.7 million (2016: £62.1 million), excluding those on instruments measured at fair value through profit or loss. These losses are largely offset by fair value gains on derivatives.
- (3) Includes an £11.9 million loss (2016: £15.1 million gain) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.
- (4) These swap contracts are not designated within an IAS 39 hedge relationship and are, as a result, classed as 'held for trading' under the accounting standard. These derivatives form economic hedges and, as such, management intends to hold these through to maturity.
- (5) Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.
- (6) Includes £15.4 million income (2016: £16.5 million) due to net interest on swaps and debt under fair value option.

Interest payable is stated net of £29.2 million (2016: £21.3 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. This has been calculated by applying a capitalisation rate of 3.0 per cent (2016: 2.7 per cent) to expenditure on such assets as prescribed by IAS 23 'Borrowing Costs'.

# Notes to the financial statements

## 6 Tax

	2017 £m	2016 £m
<b>Current tax</b>		
UK corporation tax	54.0	53.3
Adjustments in respect of prior years	(22.5)	(9.0)
Total current tax charge for the year	31.5	44.3
<b>Deferred tax</b>		
Current year	28.2	18.6
Adjustments in respect of prior years	7.0	5.6
	35.2	24.2
Change in tax rate	(58.2)	(112.5)
Total deferred tax credit for the year	(23.0)	(88.3)
Total tax charge/(credit) for the year	8.5	(44.0)

The deferred tax credit of £58.2 million (2016: £112.5 million) reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020 (2016: 20 per cent to 18 per cent from 1 April 2020). The adjustments in respect of prior years relates to agreement with the tax authorities of prior years' UK tax matters; the current year figure also includes the release of a current tax provision in relation to agreed historic overseas tax matters.

The table below reconciles the notional tax charge at the UK corporation tax rate to the effective tax rate for the year:

	2017 £m	2017 %	2016 £m	2016 %
Profit before tax	442.4		353.5	
Tax at the UK corporation tax rate	88.5	20.0	70.7	20.0
Adjustments in respect of prior years	(15.5)	(3.5)	(3.4)	(1.0)
Change in tax rate	(58.2)	(13.2)	(112.5)	(31.8)
Net (income)/expense not taxable/other	(6.3)	(1.4)	1.2	0.3
Total tax charge/(credit) and effective tax rate for the year	8.5	1.9	(44.0)	(12.5)

	2017 £m	2016 £m
<b>Tax on items taken directly to equity</b>		
<b>Current tax</b>		
Relating to other pension movements	(9.8)	–
	(9.8)	–
<b>Deferred tax (see note 19)</b>		
On remeasurement (losses)/gains on defined benefit pension schemes	(13.8)	32.0
Relating to other pension movements	8.8	–
Change in tax rate	(2.5)	(5.5)
	(7.5)	26.5
Total tax (credit)/charge on items taken directly to equity	(17.3)	26.5

The deferred tax credit of £2.5 million (2016: £5.5 million) reflects the enacted reduction in the headline rate of corporation tax to 17 per cent from 1 April 2020 (2016: 20 per cent to 18 per cent from 1 April 2020).

## 7 Earnings per share

	2017 £m	2016 £m
Profit after tax attributable to equity holders of the company	433.9	397.5
	2017 pence	2016 pence
<b>Earnings per share</b>		
Basic	63.6	58.3
Diluted	63.5	58.2

Basic earnings per share is calculated by dividing profit after tax for the financial year attributable to equity holders of the company by 681.9 million, being the weighted average number of shares in issue during the year (2016: 681.9 million). Diluted earnings per share is calculated by dividing profit after tax for the financial year attributable to equity holders of the company by 683.0 million, being the weighted average number of shares in issue during the year including dilutive shares (2016: 683.0 million).

The difference between the weighted average number of shares used in the basic and the diluted earnings per share calculations represents those ordinary shares deemed to have been issued for no consideration on the conversion of all potential dilutive ordinary shares in accordance with IAS 33 'Earnings per Share'. Potential dilutive ordinary shares comprise outstanding share options awarded to directors and certain employees (see note 2).

The weighted average number of shares can be reconciled to the weighted average number of shares including dilutive shares as follows:

	2017 million	2016 million
Average number of ordinary shares – basic	681.9	681.9
Effect of potential dilutive ordinary shares – share options	1.1	1.1
Average number of ordinary shares – diluted	683.0	683.0

## 8 Dividends

	2017 £m	2016 £m
Amounts recognised as distributions to equity holders of the company in the year comprise:		
<b>Ordinary shares</b>		
Final dividend for the year ended 31 March 2016 at 25.64 pence per share (2015: 25.14 pence)	174.8	171.4
Interim dividend for the year ended 31 March 2017 at 12.95 pence per share (2016: 12.81 pence)	88.3	87.3
	263.1	258.7
Proposed final dividend for the year ended 31 March 2017 at 25.92 pence per share (2016: 25.64 pence)	176.8	174.8

The proposed final dividends for the years ended 31 March 2017 and 31 March 2016 were subject to approval by equity holders of United Utilities Group PLC as at the reporting dates, and hence have not been included as liabilities in the consolidated financial statements at 31 March 2017 and 31 March 2016 respectively.

## 9 Disposal of non-household retail business

On 3 May 2016, the Competition and Markets Authority approved the formation of a joint venture, Water Plus Group Limited (Water Plus), between United Utilities PLC and Severn Trent PLC. On 1 June 2016, the group completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Water Plus. This resulted in a £22.1 million profit and £3.3 million of cash proceeds on disposal of the business, together with a £15.6 million disposal of assets that had been classified as held for sale. The formation of the joint venture resulted in an increase in interests in joint ventures of £39.1 million (see note 12), comprising £25.6 million of shares in the joint venture received on disposal of the non-household retail business, and £13.5 million of equity contributed during the year. The group's £2.0 million share of the joint venture's losses for the period was subsequently recognised, which included £5.2 million of initial set-up costs not expected to be incurred in future years.

# Notes to the financial statements

## 10 Property, plant and equipment

Group	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
<b>Cost</b>						
At 1 April 2015	303.6	4,888.0	6,264.0	487.2	884.4	12,827.2
Additions	4.5	98.0	106.3	7.4	449.6	665.8
Transfers	19.1	134.8	156.5	11.1	(321.5)	–
Disposals	(0.3)	(0.1)	(47.2)	(7.6)	–	(55.2)
<b>At 31 March 2016</b>	<b>326.9</b>	<b>5,120.7</b>	<b>6,479.6</b>	<b>498.1</b>	<b>1,012.5</b>	<b>13,437.8</b>
Additions	6.7	80.1	107.0	10.5	513.6	717.9
Transfers	24.3	42.3	494.6	22.6	(583.8)	–
Disposals	(3.7)	–	(48.0)	(34.4)	–	(86.1)
<b>At 31 March 2017</b>	<b>354.2</b>	<b>5,243.1</b>	<b>7,033.2</b>	<b>496.8</b>	<b>942.3</b>	<b>14,069.6</b>
<b>Accumulated depreciation</b>						
At 1 April 2015	95.5	275.2	2,441.4	298.8	–	3,110.9
Charge for the year	9.0	34.6	249.6	39.3	–	332.5
Impairment	–	–	11.4	–	–	11.4
Disposals	(0.3)	(0.1)	(42.2)	(5.8)	–	(48.4)
<b>At 31 March 2016</b>	<b>104.2</b>	<b>309.7</b>	<b>2,660.2</b>	<b>332.3</b>	<b>–</b>	<b>3,406.4</b>
Charge for the year	10.1	36.0	253.1	37.0	–	336.2
Impairment	–	–	0.2	–	–	0.2
Transfers	–	0.2	–	(0.2)	–	–
Disposals	(2.7)	–	(42.8)	(33.2)	–	(78.7)
<b>At 31 March 2017</b>	<b>111.6</b>	<b>345.9</b>	<b>2,870.7</b>	<b>335.9</b>	<b>–</b>	<b>3,664.1</b>
Net book value at 31 March 2016	222.7	4,811.0	3,819.4	165.8	1,012.5	10,031.4
<b>Net book value at 31 March 2017</b>	<b>242.6</b>	<b>4,897.2</b>	<b>4,162.5</b>	<b>160.9</b>	<b>942.3</b>	<b>10,405.5</b>

At 31 March 2017, the group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £335.2 million (2016: £439.0 million).

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

### Company

The company had no property, plant and equipment or contractual commitments for the acquisition of property, plant and equipment at 31 March 2017 or 31 March 2016.

## 11 Intangible assets

Group	Total £m
<b>Cost</b>	
At 1 April 2015	264.5
Additions	67.0
Transfer to assets classified as held for sale	(20.6)
At 31 March 2016	<b>310.9</b>
Additions	<b>54.5</b>
Disposals	<b>(8.2)</b>
<b>At 31 March 2017</b>	<b>357.2</b>
<b>Accumulated amortisation</b>	
At 1 April 2015	119.6
Charge for the year	31.2
Transfer to assets classified as held for sale	(2.3)
At 31 March 2016	<b>148.5</b>
Charge for the year	<b>28.7</b>
Disposals	<b>(7.7)</b>
<b>At 31 March 2017</b>	<b>169.5</b>
Net book value at 31 March 2016	162.4
<b>Net book value at 31 March 2017</b>	<b>187.7</b>

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

At 31 March 2017, the group had entered into contractual commitments for the acquisition of intangible assets amounting to £1.7 million (2016: £8.3 million).

### Company

The company had no intangible assets or contractual commitments for the acquisition of intangible assets at 31 March 2017 or 31 March 2016.

## 12 Joint ventures

Group	£m
At 1 April 2015	31.7
Share of profits of joint ventures	5.0
Dividends received from joint ventures	(4.6)
Currency translation differences	3.0
At 31 March 2016	<b>35.1</b>
Additions	<b>39.1</b>
Share of profits of joint ventures	<b>3.8</b>
Dividends received from joint ventures	<b>(5.4)</b>
Currency translation differences	<b>2.6</b>
<b>At 31 March 2017</b>	<b>75.2</b>

During the year ended 31 March 2017, the group recognised a £39.1 million investment in Water Plus, a joint venture formed during the year between the group and Severn Trent PLC that is jointly owned and controlled by both parties under a joint venture agreement. Further details of the formation of Water Plus are disclosed in note 9.

# Notes to the financial statements

## 12 Joint ventures continued

The group's other interests in joint ventures mainly comprise its interest in AS Tallinna Vesi (Tallinn Water). Joint management of Tallinn Water is based on a shareholders' agreement.

There are no restrictions on the ability of the group's joint ventures to transfer funds to the group in the form of cash dividends, or to repay loans or advances made by the group.

Details of transactions between the group and its joint ventures are disclosed in note A6.

### Company

The company had no investments in joint ventures at either 31 March 2017 or 31 March 2016.

## 13 Investments

<b>Group</b>	<b>£m</b>
At 1 April 2015	8.6
Disposals	(0.2)
Currency translation differences	0.3
At 31 March 2016	<b>8.7</b>
Disposals	<b>(0.9)</b>
Currency translation differences	<b>1.2</b>
<b>At 31 March 2017</b>	<b>9.0</b>

During the year, the group reduced its investment in Muharraq Holding Company 1 Limited through a £0.9 million (2016: £0.2 million) repayment of a shareholder loan.

At 31 March 2017, the group's investments mainly comprised its investment in Muharraq Holding Company 1 Limited. These investments are held at fair value.

### Company

At 31 March 2017, the company's investments related solely to its investments in United Utilities PLC, which was recorded at cost of £6,326.8 million (2016: £6,326.8 million).

## 14 Inventories

<b>Group</b>	<b>2017 £m</b>	<b>2016 £m</b>
Properties held for resale	<b>13.5</b>	19.7
Other inventories	<b>8.9</b>	9.6
	<b>22.4</b>	29.3

### Company

The company had no inventories at 31 March 2017 or 31 March 2016.

## 15 Trade and other receivables

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Trade receivables	124.7	175.1	–	–
Amounts owed by subsidiary undertakings	–	–	69.0	62.5
Amounts owed by related parties (see note A6)	163.5	2.9	–	–
Other debtors and prepayments	62.0	71.8	–	–
Accrued income	66.0	120.1	–	–
	<b>416.2</b>	<b>369.9</b>	<b>69.0</b>	<b>62.5</b>

At 31 March 2017, the group had £112.3 million (2016: £2.5 million) of trade and other receivables classified as non-current. In both years, all of the amount was owed by related parties.

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

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

Group	2017 £m	2016 £m
At the start of the year	94.4	100.5
Amounts charged to operating expenses (see note 3)	29.9	39.2
Trade receivables written off	(38.9)	(45.3)
<b>At the end of the year</b>	<b>85.4</b>	<b>94.4</b>

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

At 31 March 2017 and 31 March 2016, the group had no trade receivables that were past due and not individually impaired.

The following table provides information regarding the ageing of net trade receivables that were past due and individually impaired:

Trade receivables	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
<b>At 31 March 2017</b>	<b>79.9</b>	<b>32.0</b>	<b>5.0</b>	<b>116.9</b>
At 31 March 2016	127.0	37.5	5.1	169.6

At 31 March 2017, the group had £7.8 million (2016: £5.5 million) of trade receivables that were not past due.

### Company

At 31 March 2017 and 31 March 2016, the company had no trade receivables that were past due.

The carrying amount of trade and other receivables approximates to their fair value at 31 March 2017 and 31 March 2016.

# Notes to the financial statements

## 16 Cash and cash equivalents

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Cash at bank and in hand	1.5	4.8	–	–
Short-term bank deposits	246.3	208.8	–	–
<b>Cash and short-term deposits</b>	<b>247.8</b>	<b>213.6</b>	<b>–</b>	<b>–</b>
Book overdrafts (included in borrowings, see note 17)	(27.5)	(31.5)	(0.6)	(0.5)
<b>Cash and cash equivalents in the statement of cash flows</b>	<b>220.3</b>	<b>182.1</b>	<b>(0.6)</b>	<b>(0.5)</b>

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

Book overdrafts, which result from cash management practices, represent the value of cheques issued and payments initiated that had not cleared as at the reporting date.

## 17 Borrowings

Group	2017 £m	2016 £m
<b>Non-current liabilities</b>		
Bonds	4,851.0	4,439.2
Bank and other term borrowings	2,207.4	2,069.6
	<b>7,058.4</b>	<b>6,508.8</b>
<b>Current liabilities</b>		
Bonds	37.3	–
Bank and other term borrowings	261.3	437.7
Book overdrafts (see note 16)	27.5	31.5
	<b>326.1</b>	<b>469.2</b>
	<b>7,384.5</b>	<b>6,978.0</b>

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

Company	2017 £m	2016 £m
<b>Non-current liabilities</b>		
Amounts owed to subsidiary undertakings	1,665.4	1,636.9
	<b>1,665.4</b>	<b>1,636.9</b>
<b>Current liabilities</b>		
Book overdrafts (see note 16)	0.6	0.5
	<b>0.6</b>	<b>0.5</b>
	<b>1,666.0</b>	<b>1,637.4</b>

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

## 18 Retirement benefit surplus

### Defined benefit schemes

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

Group	2017 £m	2016 £m
Current service cost	19.7	22.3
Curtailments/settlements	3.1	1.1
Administrative expenses	2.7	2.7
<b>Pension expense charged to operating profit</b>	<b>25.5</b>	<b>26.1</b>
Net pension interest income credited to investment income (see note 4)	(10.2)	(3.1)
<b>Net pension expense charged before tax</b>	<b>15.3</b>	<b>23.0</b>

Defined benefit pension costs excluding curtailments/settlements included within employee benefit expense were £22.4 million (2016: £25.0 million) comprising current service costs and administrative expenses. Total post-employment benefits expense excluding curtailments/settlements charged to operating profit of £33.6 million (2016: £34.9 million) comprise the defined benefit costs described above of £22.4 million (2016: £25.0 million) and defined contribution pension costs of £11.2 million (2016: £9.9 million) (see note 2).

The reconciliation of the opening and closing net pension surplus included in the statement of financial position is as follows:

Group	2017 £m	2016 £m
At the start of the year	275.2	79.2
Expense recognised in the income statement	(15.3)	(23.0)
Contributions paid	64.3	58.9
Remeasurement (losses)/gains gross of tax	(76.7)	160.1
<b>At the end of the year</b>	<b>247.5</b>	<b>275.2</b>

Included in the contributions paid of £64.3 million (2016: £58.9 million) were deficit repair contributions of £43.0 million (2016: £33.3 million). No inflation funding mechanism payments were made during the year (2016: £nil).

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

Group	2017 £m	2016 £m
The return on plan assets, excluding amounts included in interest	555.5	56.0
Actuarial (losses)/gains arising from changes in financial assumptions	(721.4)	98.1
Actuarial gains/(losses) arising from changes in demographic assumptions	52.7	(46.6)
Actuarial gains arising from experience	36.5	52.6
<b>Remeasurement (losses)/gains on defined benefit pension schemes</b>	<b>(76.7)</b>	<b>160.1</b>

For more information in relation to the group's defined benefit pension schemes see note A5.

### Defined contribution schemes

During the year, the group made £11.2 million (2016: £9.9 million) of contributions to defined contribution schemes which are included in employee benefit expense (see note 2).

### Company

The company did not participate in any of the group's pension schemes during the years ended 31 March 2017 and 31 March 2016.

# Notes to the financial statements

## 19 Deferred tax liabilities

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

<b>Group</b>	<b>Accelerated tax depreciation £m</b>	<b>Retirement benefit obligations £m</b>	<b>Other £m</b>	<b>Total £m</b>
At 1 April 2015	1,125.0	16.6	(17.8)	1,123.8
(Credited)/charged to the income statement (see note 6)	(88.2)	6.5	(6.6)	(88.3)
Charged to equity (see note 6)	–	26.5	–	26.5
At 31 March 2016	<b>1,036.8</b>	<b>49.6</b>	<b>(24.4)</b>	<b>1,062.0</b>
(Credited)/charged to the income statement (see note 6)	<b>(25.4)</b>	–	<b>2.4</b>	<b>(23.0)</b>
Credited to equity (see note 6)	–	<b>(7.5)</b>	–	<b>(7.5)</b>
<b>At 31 March 2017</b>	<b>1,011.4</b>	<b>42.1</b>	<b>(22.0)</b>	<b>1,031.5</b>

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

### Company

The company had no deferred tax assets or liabilities at 31 March 2017 or 31 March 2016.

## 20 Provisions

<b>Group</b>	<b>Severance £m</b>	<b>Other £m</b>	<b>Total £m</b>
At 1 April 2015	4.8	7.7	12.5
(Credited)/charged to the income statement	(0.2)	11.5	11.3
Utilised in the year	(3.7)	(5.0)	(8.7)
At 31 March 2016	<b>0.9</b>	<b>14.2</b>	<b>15.1</b>
Charged to the income statement	<b>7.0</b>	<b>11.0</b>	<b>18.0</b>
Utilised in the year	<b>(4.2)</b>	<b>(2.4)</b>	<b>(6.6)</b>
<b>At 31 March 2017</b>	<b>3.7</b>	<b>22.8</b>	<b>26.5</b>

The group had no provisions classed as non-current at 31 March 2017 or 31 March 2016.

The severance provision as at 31 March 2017 and 31 March 2016 relates to severance costs as a result of group reorganisation.

Other provisions principally relate to contractual, legal and environmental claims against the group and represent management's best estimate of the value of settlement, the timing of which is dependent on the resolution of the relevant legal claims.

### Company

The company had no provisions at 31 March 2017 or 31 March 2016.

## 21 Trade and other payables

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
<b>Non-current</b>				
Deferred grants and contributions	570.7	517.4	–	–
Other creditors	18.6	13.1	–	–
	<b>589.3</b>	<b>530.5</b>	<b>–</b>	<b>–</b>
	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
<b>Current</b>				
Trade payables	35.2	44.1	–	–
Amounts owed to subsidiary undertakings	–	–	8.7	9.5
Amounts owed to related parties	12.1	–	–	–
Other tax and social security	5.1	4.9	–	–
Deferred grants and contributions	8.5	9.0	–	–
Accruals and other creditors	222.6	241.1	1.6	1.6
Deferred income	39.5	42.6	–	–
	<b>323.0</b>	<b>341.7</b>	<b>10.3</b>	<b>11.1</b>

The average credit period taken for trade purchases is 23 days (2016: 26 days).

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

### Deferred grants and contributions

Group	2017 £m	2016 £m
At the start of the year	526.4	485.8
Cash received during the year	29.0	17.3
Transfers of assets from customers	33.5	32.8
Credited to the income statement – revenue	(3.0)	(2.6)
Credited to the income statement – other operating costs (see note 3)	(6.7)	(6.9)
<b>At the end of the year</b>	<b>579.2</b>	<b>526.4</b>

## 22 Share capital

Group and company	2017 million	2017 £m	2016 million	2016 £m
<b>Issued, called up and fully paid</b>				
Ordinary shares of 5.0 pence each	681.9	34.1	681.9	34.1
Deferred shares of 170.0 pence each	274.0	465.7	274.0	465.7
	<b>955.9</b>	<b>499.8</b>	<b>955.9</b>	<b>499.8</b>

Details of the voting rights of each category of shares can be found within the directors' report on page 113.

# Notes to the financial statements

## 23 Operating lease commitments

<b>Group</b>	<b>Property 2017 £m</b>	<b>Plant and equipment 2017 £m</b>	<b>Property 2016 £m</b>	<b>Plant and equipment 2016 £m</b>
<b>Commitments under non-cancellable operating leases due</b>				
Within one year	2.8	0.6	3.0	0.7
In the second to fifth years inclusive	10.2	0.4	10.4	0.5
After five years	277.9	–	278.6	–
	<b>290.9</b>	<b>1.0</b>	292.0	1.2

In respect of the group's commitment to significant property leases, there are no contingent rentals payable, or restrictions on dividends, debt or further leasing imposed by these lease arrangements. Wherever possible, the group ensures that it has the benefit of security of tenure where this is required by operational and accommodation strategies. Escalation of rents is via rent reviews at agreed intervals.

The company had no operating lease commitments at 31 March 2017 or 31 March 2016.

## 24 Contingent liabilities

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP), though at this stage it is not possible to quantify the impact of legislative changes proposed by the UK Government in this area. See note A5 for further details.

Following a review undertaken during the year, the group has determined that the possibility of any outflow in respect of performance guarantees issued is remote and, as such, there are no contingent liabilities to be disclosed in respect of these (2016: £9.8 million).

The company has not entered into performance guarantees as at 31 March 2017 or 31 March 2016.

## 25 Events after the reporting period

There were no events arising after the reporting date that require recognition or disclosure in the financial statements for the year ended 31 March 2017.

# Notes to the financial statements – appendices

## A1 Cash generated from operations

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit before tax	442.4	353.5	235.4	230.8
Adjustment for investment income (see note 4) and finance expense (see note 5)	189.0	219.4	27.7	27.9
Adjustment for profit on disposal of business (see note 9)	(22.1)	–	–	–
Adjustment for share of profits of joint ventures (see note 12)	(3.8)	(5.0)	–	–
Operating profit	605.5	567.9	263.1	258.7
Adjustments for:				
Depreciation of property, plant and equipment (see note 10)	336.2	332.5	–	–
Amortisation of intangible assets (see note 11)	28.7	31.2	–	–
Impairment of property, plant and equipment (see note 10)	0.2	11.4	–	–
Impairment of assets classified as available for sale	–	2.7	–	–
Loss on disposal of property, plant and equipment (see note 3)	3.3	5.4	–	–
Loss on disposal of intangible assets	0.5	–	–	–
Amortisation of deferred grants and contributions (see note 21)	(6.7)	(6.9)	–	–
Equity-settled share-based payments charge (see note 2)	3.4	2.3	–	–
Other non-cash movements	(3.0)	(3.8)	–	–
Changes in working capital:				
Decrease in inventories (see note 14)	6.9	11.2	–	–
Decrease/(increase) in trade and other receivables	71.1	(14.1)	2.3	2.6
Decrease in trade and other payables	(0.6)	(4.1)	–	–
Increase in provisions (see note 20)	11.4	2.6	–	–
Pension contributions paid less pension expense charged to operating profit	(38.8)	(32.8)	–	–
Cash generated from operations	1,018.1	905.5	265.4	261.3

The group has received property, plant and equipment of £33.5 million (2016: £32.8 million) in exchange for the provision of future goods and services (see notes 21 and A7).

## A2 Net debt

Group	2017 £m	2016 £m
At the start of the year	6,260.5	5,924.0
Net capital expenditure	691.7	681.6
Dividends (see note 8)	263.1	258.7
Loans to joint ventures	109.0	–
Interest	156.1	166.8
Inflation uplift on index-linked debt (see note 5)	80.7	37.9
Tax	41.2	53.1
Other	4.4	1.5
Fair value movements*	(9.9)	42.4
Cash generated from operations (see note A1)	(1,018.1)	(905.5)
At the end of the year	6,578.7	6,260.5

\* Fair value movements includes net fair value gains on debt and derivative instruments of £24.3 million (2016: £26.3 million losses), less £14.4 million (2016: £16.1 million) of net receipts on swaps and debt under fair value option (see note 5).

Net debt comprises borrowings, net of cash and short-term deposits and derivatives.

# Notes to the financial statements – appendices

## A3 Borrowings

### Terms and debt repayment schedule

The principal economic terms and conditions of outstanding borrowings, along with fair value and carrying value, were as follows:

	Currency	Year of final repayment	Fair value	Carrying value	Fair value	Carrying value
			2017 £m	2017 £m	2016 £m	2016 £m
<b>Borrowings in fair value hedge relationships</b>			<b>2,544.6</b>	<b>2,522.4</b>	2,293.0	2,373.0
5.375% 150m bond	GBP	2018	164.3	156.8	169.6	162.5
4.55% 250m bond	USD	2018	208.1	204.7	183.9	185.6
5.375% 350m bond	USD	2019	295.3	294.8	263.2	269.3
4.25% 500m bond	EUR	2020	478.9	469.7	455.9	455.1
5.75% 375m bond	GBP	2022	455.4	429.3	449.5	434.5
5.625% 300m bond	GBP	2027	408.7	412.1	382.7	411.1
1.129% 52m bond	EUR	2027	43.5	43.6	38.4	41.0
5.02% JPY 10bn dual currency loan	JPY/USD	2029	97.7	105.8	81.4	96.1
2.058% 30m bond	EUR	2030	27.0	26.3	23.7	25.1
1.641% 30m bond	EUR	2031	25.7	24.6	–	–
2.9% 600m bond	HKD	2031	61.1	56.4	–	–
5.0% 200m bond	GBP	2035	278.9	298.3	244.7	292.7
<b>Borrowings designated at fair value through profit or loss</b>			<b>375.5</b>	<b>375.5</b>	338.0	338.0
6.875% 400m bond	USD	2028	375.5	375.5	338.0	338.0
<b>Borrowings measured at amortised cost</b>			<b>5,682.8</b>	<b>4,486.6</b>	4,830.1	4,267.0
1.97%+RPI 200m EIB IL loan	GBP	2016	–	–	269.9	267.4
Short-term bank borrowings – fixed	GBP	2017	202.0	202.0	127.5	127.5
1.30%+LIBOR 5bn bond	JPY	2017	36.3	37.3	31.7	32.0
2.46%+RPI 50m EIB IL loan	GBP	2020	69.3	60.8	65.7	59.3
2.10%+RPI 50m EIB IL loan	GBP	2020	68.5	60.8	64.7	59.3
1.93%+RPI 50m EIB IL loan	GBP	2020	68.2	60.9	64.5	59.4
1.90%+RPI 50m EIB IL loan	GBP	2020	68.2	61.0	64.5	59.5
1.88%+RPI 50m EIB IL loan	GBP	2020	68.1	60.9	64.2	59.3
1.84%+RPI 50m EIB IL loan	GBP	2020	68.2	61.1	64.4	59.6
1.73%+RPI 50m EIB IL loan	GBP	2020	68.0	61.2	64.2	59.6
1.61%+RPI 50m EIB IL loan	GBP	2020	67.8	61.2	63.9	59.7
0.80%+LIBOR 100m loan	GBP	2022	102.6	100.0	98.3	100.0
0.47%+RPI 100m IL loan	GBP	2023	116.5	107.9	105.0	105.2
0.49%+RPI 100m IL loan	GBP	2025	115.6	103.8	101.1	101.2
0.013%+RPI 25m IL bond	GBP	2025	28.1	25.9	24.2	25.2
0.1275%+RPI 100m IL loan	GBP	2026	112.3	102.4	96.4	100.0
0.01%+RPI 20m IL bond	GBP	2028	22.0	22.3	–	–
1.29%+RPI 50m EIB (amortising) IL loan	GBP	2029	57.4	51.5	58.6	54.2
1.23%+RPI 50m EIB (amortising) IL loan	GBP	2029	55.1	49.7	54.6	52.5
1.12%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.5	51.0	57.6	53.7
1.10%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.3	51.0	57.4	53.7
0.75%+RPI 50m EIB (amortising) IL loan	GBP	2029	56.5	51.9	55.2	54.4
1.15%+RPI 50m EIB (amortising) IL loan	GBP	2030	57.5	51.5	56.2	54.1
1.11%+RPI 50m EIB (amortising) IL loan	GBP	2030	57.6	51.7	56.2	54.2
0.76%+RPI 50m EIB (amortising) IL loan	GBP	2030	56.4	51.7	55.0	54.3
0.178%+RPI 35m IL bond	GBP	2030	40.2	36.2	33.6	35.3
0.245%+CPI 20m IL bond	GBP	2031	20.2	20.0	–	–

## A3 Borrowings continued

	Currency	Year of final repayment	Fair value	Carrying value	Fair value	Carrying value
			2017 £m	2017 £m	2016 £m	2016 £m
<b>Borrowings measured at amortised cost (continued)</b>						
0.01%+RPI 38m IL bond	GBP	2031	42.2	41.3	–	–
3.375%+RPI 50m IL bond	GBP	2032	124.1	74.2	107.6	72.8
0.709%+LIBOR 100m EIB (amortising) loan	GBP	2032	94.9	93.8	95.6	100.0
0.691%+LIBOR 150m EIB (amortising) loan	GBP	2032	146.4	145.3	142.9	150.0
0.573%+LIBOR 100m EIB (amortising) loan	GBP	2033	100.2	100.0	93.7	100.0
0.511%+LIBOR 150m EIB (amortising) loan	GBP	2033	149.6	150.0	140.0	150.0
0.01%+RPI 100m EIB (amortising) IL loan	GBP	2033	107.9	102.3	94.7	99.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.9	76.7	71.1	74.7
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.7	76.2	–	–
0.01%+RPI 75m EIB (amortising) IL loan	GBP	2034	80.7	76.2	–	–
1.9799%+RPI 100m IL bond	GBP	2035	212.4	138.9	171.4	136.4
0.379%+CPI 20m IL bond	GBP	2036	20.9	20.0	–	–
0.01%+RPI 26.5m IL bond	GBP	2036	30.3	31.0	–	–
0.01%+RPI 29m IL bond	GBP	2036	32.2	31.5	–	–
1.66%+RPI 35m IL bond	GBP	2037	62.7	44.7	51.6	43.6
0.093%+CPI 60m IL bond	GBP	2037	59.0	59.6	–	–
2.40%+RPI 70m IL bond	GBP	2039	132.2	87.2	113.5	85.0
1.7829%+RPI 100m IL bond	GBP	2040	207.5	137.5	172.8	135.0
1.3258%+RPI 50m IL bond	GBP	2041	95.7	68.6	78.9	67.3
1.5802%+RPI 100m IL bond	GBP	2042	202.6	137.0	166.6	134.5
1.5366%+RPI 50m IL bond	GBP	2043	102.4	68.4	82.5	67.1
1.397%+RPI 50m IL bond	GBP	2046	102.9	68.5	81.8	67.3
1.7937%+RPI 50m IL bond	GBP	2049	118.0	68.2	91.1	67.0
Commission for New Towns (amortising) loan – fixed	GBP	2053	56.1	28.4	52.5	28.7
1.847%+RPI 100m IL bond	GBP	2056	224.1	135.0	180.8	131.6
1.815%+RPI 100m IL bond	GBP	2056	221.5	134.4	179.4	131.0
1.662%+RPI 100m IL bond	GBP	2056	218.2	134.2	173.1	130.8
1.591%+RPI 25m IL bond	GBP	2056	52.5	33.4	42.4	32.6
1.5865%+RPI 50m IL bond	GBP	2056	105.8	67.0	85.6	65.3
1.556%+RPI 50m IL bond	GBP	2056	105.3	66.7	84.5	65.0
1.435%+RPI 50m IL bond	GBP	2056	102.5	66.5	82.0	64.8
1.3805%+RPI 35m IL bond	GBP	2056	71.0	46.5	56.7	45.3
1.702%+RPI 50m IL bond	GBP	2057	107.9	65.1	86.1	63.5
1.585%+RPI 100m IL bond	GBP	2057	208.6	129.1	165.1	125.9
Book overdrafts (see note 16)	GBP	2017	27.5	27.5	31.5	31.5
			<b>8,602.9</b>	<b>7,384.5</b>	7,461.1	6,978.0

IL Index-linked debt – this debt is adjusted for movements in the Consumer or Retail Prices Indices with reference to a base CPI or RPI established at trade date

CPI The UK general index of consumer prices (for all items) as published by the Office for National Statistics (May 2015 = 100)

RPI The UK general index of retail prices (for all items) as published by the Office for National Statistics (Jan 1987 = 100)

EIB Borrowings that are held with the European Investment Bank

Borrowings in the above table are unsecured. Funding raised in foreign currencies is swapped to sterling to match funding costs to income and assets.

# Notes to the financial statements – appendices

## A4 Financial risk management

### Risk management

The board is responsible for treasury strategy and governance, which is reviewed on an annual basis.

The treasury committee, a subcommittee of the board, has responsibility for setting and monitoring the group's adherence to treasury policies, along with oversight in relation to the activities of the treasury function.

Treasury policies cover the key financial risks: liquidity risk, credit risk, market risk (inflation, interest rate, electricity price and currency) and capital risk. These policies are reviewed by the treasury committee for approval on at least an annual basis, or following any major changes in treasury operations and/or financial market conditions.

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

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

### Liquidity risk

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

At 31 March 2017, the group had £1,147.8 million (2016: £888.6 million) of available liquidity, which comprised £247.8 million (2016: £213.6 million) of cash and short-term deposits, £725.0 million (2016: £600.0 million) of undrawn committed borrowing facilities, and £175.0 million (2016: £75.0 million) of undrawn term loan facilities. Short-term deposits mature within three months.

The group had available committed borrowing facilities as follows:

<b>Group</b>	<b>2017</b>	<b>2016</b>
	<b>£m</b>	<b>£m</b>
Expiring within one year	<b>150.0</b>	150.0
Expiring after one year but in less than two years	<b>100.0</b>	150.0
Expiring after more than two years	<b>500.0</b>	300.0
Total borrowing facilities	<b>750.0</b>	600.0
Facilities drawn <sup>(1)</sup>	<b>(25.0)</b>	–
Undrawn borrowing facilities	<b>725.0</b>	600.0

Note:

(1) Facilities expiring after more than two years.

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

### Company

The company did not have any committed facilities available at 31 March 2017 or 31 March 2016.

## A4 Financial risk management continued

### Maturity analysis

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

Group At 31 March 2017	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Bonds	9,926.5		191.9	771.4	563.2	107.2	482.9	7,809.9
Bank and other term borrowings	3,061.4		318.5	110.9	117.8	663.4	111.6	1,739.2
Adjustment to carrying value <sup>(2)</sup>	(5,603.4)	(5,603.4)						
Borrowings	7,384.5	(5,603.4)	510.4	882.3	681.0	770.6	594.5	9,549.1
Derivatives:								
Payable	1,292.1		143.3	397.8	491.2	33.3	25.0	201.5
Receivable	(1,855.3)		(245.5)	(807.9)	(518.7)	(10.7)	(10.6)	(261.9)
Adjustment to carrying value <sup>(2)</sup>	5.2	5.2						
Derivatives – net assets	(558.0)	5.2	(102.2)	(410.1)	(27.5)	22.6	14.4	(60.4)

At 31 March 2016	Total <sup>(1)</sup> £m	Adjust- ment <sup>(2)</sup> £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
Bonds	9,620.9		146.4	178.9	707.4	535.9	103.7	7,948.6
Bank and other term borrowings	3,148.8		505.8	89.8	107.4	109.7	656.9	1,679.2
Adjustment to carrying value <sup>(2)</sup>	(5,791.7)	(5,791.7)						
Borrowings	6,978.0	(5,791.7)	652.2	268.7	814.8	645.6	760.6	9,627.8
Derivatives:								
Payable	1,154.6		94.7	117.1	393.2	411.1	26.4	112.1
Receivable	(1,671.3)		(128.1)	(196.2)	(700.0)	(485.4)	(8.0)	(153.6)
Adjustment to carrying value <sup>(2)</sup>	12.8	12.8						
Derivatives – net assets	(503.9)	12.8	(33.4)	(79.1)	(306.8)	(74.3)	18.4	(41.5)

Notes:

- (1) Forecast future cash flows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are therefore susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be three per cent and CPI will be two per cent over the life of each instrument.
- (2) The carrying value of debt is calculated following various methods in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and therefore this adjustment reconciles the undiscounted forecast future cash flows to the carrying value of debt in the statement of financial position.

### Company

The company has total borrowings of £0.6 million (2016: £0.5 million), which are payable within one year, and £1,665.4 million (2016: £1,636.9 million), which are payable within one to two years.

### Credit risk

Credit risk arises principally from trading (the supply of services to customers) and treasury activities (the depositing of cash and holding of derivative and foreign exchange instruments). While the opening of the non-household retail market to competition from 1 April 2017 has impacted on the profile of the group's concentration of credit risk, as discussed further overleaf, the group does not believe it is exposed to any material concentrations that could have an impact on its ability to continue as a going concern or its longer-term viability.

# Notes to the financial statements – appendices

## A4 Financial risk management continued

The group manages its risk from trading through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the majority of the group's customer base consisting of a large number of unrelated households. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings.

Following the sale of the group's non-household business on 1 June 2016 and the non-household retail market opening to competition, credit risk in this area is now concentrated to a small number of retailers to whom the group provides wholesale water and wastewater services. Retailers are licensed and monitored by Ofwat and as part of the regulations they must demonstrate that they have adequate resources available to supply services. The group's retail customers are on 30 day credit terms in respect of trading transactions. As at 31 March 2017, Water Plus was the group's single largest debtor, with amounts outstanding in relation to wholesale services of £40.8 million (2016: £nil). During the year, sales to Water Plus in relation to wholesale services were £402.7 million (2016: £nil). Details of transactions with Water Plus can be found in note A6.

Under the group's revenue recognition policy, revenue is only recognised when collection of the resulting receivable is reasonably assured. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 15). An allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable.

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

At 31 March 2017 and 31 March 2016, the maximum exposure to credit risk for the group and company is represented by the carrying amount of each financial asset in the statement of financial position:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Cash and short-term deposits (see note 16)	247.8	213.6	–	–
Trade and other receivables (see note 15)*	416.2	369.9	69.0	62.5
Investments (see note 13)	9.0	8.7	–	–
Derivative financial instruments	807.7	765.6	–	–
	1,480.7	1,357.8	69.0	62.5

\* Included within trade and other receivables is £122.0 million of amounts owed by joint ventures in respect of borrowings, further details of which are disclosed in note A6.

The credit exposure on derivatives is disclosed gross of any collateral held. At 31 March 2017, the group held £176.9 million (2016: £127.5 million) as collateral in relation to derivative financial instruments (included within borrowings in note A3).

### Market risk

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

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

### Inflation risk

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

The group's index-linked borrowings that are linked to RPI inflation form an economic hedge of the group'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 group's pension obligations also provide an economic hedge of the group's regulatory assets. The pension schemes' inflation funding mechanism (see note A5) 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 unexpected RCV movements caused by inflation.

## A4 Financial risk management continued

Ofwat has indicated that from April 2020 the inflation return as an uplift to RCV will still comprise an element that will be linked to RPI; however, this will commence transition towards CPI. As a result, the group will identify opportunities to amend the economic hedge currently in place which can be evidenced by the issuing of £100.0 million of CPI indexed-linked debt during the year. Inflation risk is reported monthly to the treasury committee in the operational compliance report.

The carrying value of index-linked debt held by the group was £3,602.3 million at 31 March 2017 (2016: £3,447.3 million).

### Sensitivity analysis

The following table details the sensitivity of profit before tax to changes in the RPI and CPI on the group's index-linked borrowings. The sensitivity analysis has been based on the amount of index-linked debt held at the reporting date and, as such, is not indicative of the years then ended. In addition, it excludes the hedging aspect of the group's regulatory assets and post-retirement obligations described above.

	2017 £m	2016 £m
<b>Increase/(decrease) in profit before tax and equity</b>		
1 per cent increase in RPI/CPI	(36.4)	(35.0)
1 per cent decrease in RPI/CPI	36.4	35.0

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

### Company

The company had no material exposure to inflation risk at 31 March 2017 or 31 March 2016.

### Interest rate risk

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

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 the exposure to medium-term interest rates, the group fixes underlying interest rates on nominal debt out to 10 years in advance on a reducing balance basis. This is supplemented by managing residual exposure to interest rates within the relevant regulatory price control period by fixing substantively all residual floating underlying interest rates on projected nominal debt across the immediately forthcoming regulatory period at around the time of the price control determination.

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

### Sensitivity analysis

The following table details the sensitivity of the group's profit before tax and equity to changes in interest rates. The sensitivity analysis has been based on the amount of net debt and the interest rate hedge positions in place at the reporting date and, as such, is not indicative of the years then ended.

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
<b>Increase/(decrease) in profit before tax and equity</b>				
1 per cent increase in interest rate	155.7	175.6	(16.7)	(16.4)
1 per cent decrease in interest rate	(153.6)	(183.0)	16.7	16.4

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

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

# Notes to the financial statements – appendices

## A4 Financial risk management continued

### Repricing analysis

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

Our largest concentration of floating interest rate risk is with index-linked instruments. This has been classified as repricing in one year or less due to the refinancing of the interest charge with changes in RPI and CPI.

Group At 31 March 2017	Total £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
<b>Borrowings in fair value hedge relationships</b>							
Fixed rate instruments	2,522.4	–	656.3	469.7	–	429.3	967.1
Effect of swaps	–	2,522.4	(656.3)	(469.7)	–	(429.3)	(967.1)
	2,522.4	2,522.4	–	–	–	–	–
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	375.5	–	–	–	–	–	375.5
Effect of swaps	–	375.5	–	–	–	–	(375.5)
	375.5	375.5	–	–	–	–	–
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	230.4	202.5	0.5	0.6	0.6	0.7	25.5
Floating rate instruments	653.9	653.9	–	–	–	–	–
Index-linked instruments	3,602.3	3,602.3	–	–	–	–	–
	4,486.6	4,458.7	0.5	0.6	0.6	0.7	25.5
Effect of fixed interest rate swaps	–	(3,131.3)	(50.0)	1,127.1	325.0	–	1,729.2
<b>Total borrowings</b>	<b>7,384.5</b>	<b>4,225.3</b>	<b>(49.5)</b>	<b>1,127.7</b>	<b>325.6</b>	<b>0.7</b>	<b>1,754.7</b>
Cash and short-term deposits	(247.8)	(247.8)	–	–	–	–	–
<b>Net borrowings</b>	<b>7,136.7</b>	<b>3,977.5</b>	<b>(49.5)</b>	<b>1,127.7</b>	<b>325.6</b>	<b>0.7</b>	<b>1,754.7</b>

At 31 March 2016	Total £m	1 year or less £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m
<b>Borrowings in fair value hedge relationships</b>							
Fixed rate instruments	2,373.0	–	–	617.4	455.1	–	1,300.5
Effect of swaps	–	2,373.0	–	(617.4)	(455.1)	–	(1,300.5)
	2,373.0	2,373.0	–	–	–	–	–
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	338.0	–	–	–	–	–	338.0
Effect of swaps	–	338.0	–	–	–	–	(338.0)
	338.0	338.0	–	–	–	–	–
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	156.2	127.7	0.5	0.5	0.6	0.6	26.3
Floating rate instruments	663.5	663.5	–	–	–	–	–
Index-linked instruments	3,447.3	3,447.3	–	–	–	–	–
	4,267.0	4,238.5	0.5	0.5	0.6	0.6	26.3
Effect of fixed interest rate swaps	–	(3,006.3)	(125.0)	(50.0)	1,127.1	325.0	1,729.2
<b>Total borrowings</b>	<b>6,978.0</b>	<b>3,943.2</b>	<b>(124.5)</b>	<b>(49.5)</b>	<b>1,127.7</b>	<b>325.6</b>	<b>1,755.5</b>
Cash and short-term deposits	(213.6)	(213.6)	–	–	–	–	–
<b>Net borrowings</b>	<b>6,764.4</b>	<b>3,729.6</b>	<b>(124.5)</b>	<b>(49.5)</b>	<b>1,127.7</b>	<b>325.6</b>	<b>1,755.5</b>

## A4 Financial risk management continued

Company	2017		2016	
	Total £m	1 year or less £m	Total £m	1 year or less £m
<b>Borrowings measured at amortised cost</b>				
Floating rate instruments	1,666.0	1,666.0	1,637.4	1,637.4
<b>Total borrowings</b>	<b>1,666.0</b>	<b>1,666.0</b>	1,637.4	1,637.4

### Electricity price risk

The group is allowed a fixed amount of revenue by the regulator, in real terms, to cover electricity costs for each five-year regulatory pricing period. To the extent that electricity prices remain floating over this period, this exposes the group to volatility in its operating cash flows. The group's policy, therefore, is to manage this risk by fixing a proportion of electricity commodity prices in a cost-effective manner. The group has fixed the price on a substantial proportion of its anticipated net electricity usage out to the end of the AMP in 2020, partially through entering into electricity swap contracts.

### Sensitivity analysis

The following table details the sensitivity of the group's profit before tax and equity to changes in electricity prices. The sensitivity analysis has been based on the amounts of electricity swaps in place at the reporting date and, as such, is not indicative of the years then ended.

	2017 £m	2016 £m
<b>Increase/(decrease) in profit before tax and equity</b>		
20 per cent increase in electricity commodity prices	9.8	7.7
20 per cent decrease in electricity commodity prices	(9.8)	(7.7)

The company has no exposure to electricity price risk.

### 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 often designated within a fair value accounting hedge.

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

The group and company have no material net exposure to movements in currency rates.

### Capital risk management

The group's objective when managing capital is to maintain efficient access to debt capital markets throughout the economic cycle. The board therefore believes that it is appropriate to maintain gearing, measured as group consolidated net debt (including derivatives) to regulatory capital value (RCV) of United Utilities Water Limited (UW), within a target range of 55 per cent to 65 per cent. As at 31 March 2017, group consolidated gearing was 61 per cent (2016: 61 per cent), which is comfortably within this range.

Assuming no significant changes to existing rating agencies' methodologies or sector risk assessments, the group aims to maintain, as a minimum, its existing credit ratings of A3 with Moody's Investors Service (Moody's) and BBB+ with Standard & Poor's Ratings Services (Standard & Poor's) for UW and debt issued by its financing subsidiary, United Utilities Water Finance PLC.

In order to maintain existing credit ratings, the group needs to manage its capital structure with reference to the ratings methodology and measures used by Moody's and Standard & Poor's. The ratings methodology is normally based on a number of key ratios (such as RCV gearing, adjusted interest cover and Funds from Operations (FFO) to debt) and threshold levels as updated and published from time to time by Moody's and Standard & Poor's. The group looks to manage its risk by maintaining the relevant key financial ratios used by the credit rating agencies to determine a corporate's credit rating, within the thresholds approved by the board. Capital risk is reported monthly to the treasury committee through the operational compliance report.

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

# Notes to the financial statements – appendices

## A4 Financial risk management continued

### Fair values

The table below sets out the valuation basis of financial instruments held at fair value and financial instruments where fair value has been separately disclosed in the notes as the carrying value is not a reasonable approximation of fair value.

Group 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Available for sale financial assets</b>				
Investments	–	9.0	–	9.0
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets – fair value hedge	–	591.1	–	591.1
Derivative financial assets – held for trading <sup>(1)</sup>	–	216.6	–	216.6
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities – held for trading <sup>(1)</sup>	–	(249.7)	–	(249.7)
Financial liabilities designated as fair value through profit or loss	–	(375.5)	–	(375.5)
<b>Financial instruments for which fair value has been disclosed</b>				
Financial liabilities in fair value hedge relationships	(1,766.1)	(778.5)	–	(2,544.6)
Other financial liabilities at amortised cost	(937.9)	(4,744.9)	–	(5,682.8)
	<b>(2,704.0)</b>	<b>(5,331.9)</b>	–	<b>(8,035.9)</b>
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
2016				
<b>Available for sale financial assets</b>				
Investments	–	8.7	–	8.7
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets – fair value hedge	–	583.8	–	583.8
Derivative financial assets – held for trading <sup>(1)</sup>	–	181.8	–	181.8
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities – held for trading <sup>(1)</sup>	–	(261.7)	–	(261.7)
Financial liabilities designated as fair value through profit or loss	–	(338.0)	–	(338.0)
<b>Financial instruments for which fair value has been disclosed</b>				
Financial liabilities in fair value hedge relationships	(2,149.5)	(143.5)	–	(2,293.0)
Other financial liabilities at amortised cost	(1,309.9)	(3,520.2)	–	(4,830.1)
	<b>(3,459.4)</b>	<b>(3,489.1)</b>	–	<b>(6,948.5)</b>

Note:

(1) These derivatives form economic hedges and, as such, management intends to hold these through to maturity. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £215.7 million (2016: £177.2 million).

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

The group has calculated fair values using quoted prices where an active market exists, which has resulted in £2,704.0 million (2016: £3,459.4 million) of 'level 1' fair value measurements. In the absence of an appropriate quoted price, the group has applied discounted cash flow valuation models utilising market available data in line with prior years. The £755.4 million reduction (2016: £1,213.5 million increase) in 'level 1' fair value measurements is largely due to a decrease in the number of observable quoted bond prices in active markets at 31 March 2017.

During the year, changes in the fair value of financial liabilities designated at fair value through profit or loss resulted in a £37.5 million loss (2016: £4.3 million). Included within this was an £11.9 million loss (2016: £15.1 million gain) attributable to changes in own credit risk. The cumulative amount recognised in the income statement due to changes in credit spread was £62.2 million profit (2016: £74.1 million). The carrying amount is £173.4 million (2016: £135.9 million) higher than the amount contracted to settle on maturity.

## A4 Financial risk management continued

### Company

The company does not hold any financial instruments that are measured subsequent to initial recognition at fair value or where fair value has been separately disclosed in the notes as the carrying value is not a reasonable approximation of fair value.

## A5 Retirement benefits

### Defined benefit schemes

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

The trustees are composed of representatives of both the employer and employees. The trustees are required by law to act in the interests of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day-to-day administration of the benefits.

The group also operates a series of unfunded, unregistered retirement benefit schemes. The costs of these schemes are included in the total pension cost, on a basis consistent with IAS 19 'Employee Benefits' and the assumptions set out below.

Information about the pension arrangements for executive directors is contained in the directors' remuneration report.

Under the schemes, employees are entitled to annual pensions on retirement. Benefits are also payable on death and following other events such as withdrawing from active service. No other post-retirement benefits are provided to these employees.

The defined benefit obligation includes benefits for current employees, former employees and current pensioners as analysed in the table below:

Group	2017 £m	2016 £m
Total value of current employees benefits	917.5	831.6
Deferred members benefits	798.9	624.1
Pensioner members benefits	1,899.1	1,514.7
<b>Total defined benefit obligation</b>	<b>3,615.5</b>	<b>2,970.4</b>

The duration of the combined schemes is around 21 years. The schemes' duration is an indicator of the weighted-average time until benefit payments are settled, taking account of the split of the defined benefit obligation between current employees, deferred members and the current pensioners of the schemes.

### Funding requirements

The latest finalised funding valuations of the schemes were carried out by independent qualified actuaries as at 31 March 2013 (UUPS) and 31 March 2016 (ESPS) and determined that the schemes were both in a deficit position on a funding basis. The basis on which scheme liabilities are valued for funding purposes differs from the basis required under IAS 19, with liabilities on a funding basis being subject to assumptions at the valuation date that are not updated between revaluations. Funding deficits vary significantly from company to company, but neither the deficits, the assumptions on which they are based, the associated sensitivities, nor the risk exposures are disclosed by many companies and therefore meaningful cross-company comparisons are not possible. Conversely, scheme liabilities are valued on a consistent basis between companies under IAS 19 and are subject to assumptions and sensitivities that are required to be disclosed. Consequently, the relative economic positions of companies are comparable only on an IAS 19 basis, subject to normalisation of assumptions used between companies.

A retirement benefit surplus was recognised as an asset at both 31 March 2017 and 31 March 2016 as, under both the UUPS and ESPS scheme rules, the group has an unconditional right to a refund of the surplus assuming the full settlement of the plans' liabilities in a single event, such as a scheme wind-up.

Under UK legislation there is a requirement that pension schemes are funded prudently, and that funding plans are agreed by pension scheme trustees. The group has plans in place with the schemes' trustees to address the funding deficits by 31 December 2020 for the UUPS and 30 September 2024 for the ESPS, through a series of deficit recovery contributions. The group and trustees have agreed long-term strategies for reducing investment risk in each scheme.

For UUPS, this includes an asset-liability matching policy which aims to reduce the volatility of the funding level of the pension plan by investing in assets such as fixed income swaps and gilts which perform in line with the liabilities so as to hedge against changes in swap and gilt yields. For ESPS, a partial hedge is in place to protect against changes in swap and gilt yields. Further details of the derivatives used in reducing investment risk are disclosed in the 'Further reporting analysis' section of this appendix.

# Notes to the financial statements – appendices

## A5 Retirement benefits continued

In addition, the group has had an Inflation Funding Mechanism (IFM) in place since 2010 for the UUPS, which was extended to the ESPS in 2013. Under the IFM, additional contributions may be payable annually, calculated with reference to a notional amount of liabilities and the difference between outturn inflation and a fixed inflation assumption, currently set at 3.0 per cent per annum. To the extent that outturn inflation exceeds the fixed inflation assumption, additional contributions are payable in the following year and the base on which future payments are calculated increases, resulting in the smoothing of inflation effects over future years. If outturn inflation is less than the fixed inflation assumption, no additional contributions are payable. The IFM does not have an accounting impact except to the extent that resulting cash contributions increase the level of scheme assets.

The group expects to make contributions of £62.5 million in the year ending 31 March 2018, comprising £38.9 million to the UUPS and £4.1 million to the ESPS in respect of deficit repair contributions, £18.2 million and £0.7 million in respect of regular contributions to UUPS and ESPS respectively, and £0.6 million in respect of expenses to the ESPS; no additional contributions are expected to be made under the IFM.

The schemes' funding plans are reviewed every three years. The UUPS funding valuation at 31 March 2016 is currently ongoing and the next funding valuation for the ESPS is due no later than 31 March 2019.

### Impact of scheme risk management on IAS 19 disclosures

Under the prescribed IAS 19 basis, pension scheme liabilities are calculated based on current accrued benefits. Expected cash flows are projected forward allowing for RPI and the current member mortality assumptions. These projected cash flows are then discounted by a high quality corporate bond rate, which comprises an underlying interest rate and a credit spread.

The group has de-risked its pension schemes through hedging strategies applied to the underlying interest rate and the forecast RPI. The underlying interest rate has been largely hedged through external market swaps and gilts, the value of which is included in the schemes' assets, and the forecast RPI has been largely hedged through the IFM, with RPI in excess of 3.0 per cent per annum being funded through an additional schedule of deficit contributions, and through external market hedges.

As a consequence, the reported statement of financial position under IAS 19 remains volatile to changes in credit spread which have not been hedged, primarily due to the difficulties in doing so over long durations; changes in inflation, as the IFM results in changes to the IFM deficit contributions rather than a change in the schemes' assets; and, to a lesser extent, changes in mortality as management has decided, at the current time, not to hedge this exposure due to its lower volatility in the short term and the relatively high hedging costs.

In contrast, the schemes' specific funding basis, which forms the basis for regular (non-IFM) deficit repair contributions, is unlikely to suffer from significant volatility due to credit spread or inflation. This is because a prudent, fixed credit spread assumption is applied, and inflation-linked contributions are included within the IFM.

In the year ended 31 March 2017, the discount rate has fallen by 0.85 per cent, which includes a 0.6 per cent decrease in credit spreads and a 0.25 per cent decrease in swap yields over the year. The IAS 19 remeasurement loss of £76.7 million reported in note 18 has largely resulted from the impact of the decrease in credit spreads during the year, partially offset by growth asset gains, the reduction in swap yields and the favourable impact of changes in mortality during the year.

### Reporting and assumptions

The results of the latest funding valuations at 31 March 2016 for ESPS, and 31 March 2013 for UUPS, have been adjusted for IAS 19 in order to assess the position at 31 March 2017, by taking account of experience over the period, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service costs, were measured using the projected unit credit method.

Member data used in arriving at the liability figure included within the overall IAS 19 surplus has been based on the finalised actuarial valuation as at 31 March 2016 for ESPS and the preliminary results of the actuarial valuation as at 31 March 2016 for UUPS.

### Financial assumptions

The main financial and demographic assumptions used by the actuary to calculate the defined benefit surplus of UUPS and ESPS are outlined below:

Group	2017 % p.a.	2016 % p.a.
Discount rate	2.55	3.40
Pensionable salary growth and pension increases	3.40	3.20
Price inflation	3.40	3.20

## A5 Retirement benefits continued

### Demographic assumptions

Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S2PA (2016: S1NA) year of birth tables, with scaling factor of 108 per cent for males and 102 per cent for females (2016: one-year age rating for males in the UUPS only), reflecting actual mortality experience; and CMI 2015 (2016: CMI 2014) long-term improvement factors, with a long-term annual rate of improvement of 1.75 per cent (2016: 1.75 per cent). The current life expectancies at age 60 underlying the value of the accrued liabilities for the schemes are:

Group	2017 years	2016 years
Retired member – male	27.0	27.1
Non-retired member – male	29.0	29.2
Retired member – female	29.8	30.7
Non-retired member – female	31.9	32.9

### Sensitivity of the key scheme assumptions

The measurement of the group's defined benefit surplus is sensitive to changes in key assumptions, which are described above. The sensitivity calculations presented below allow for the specified movement in the relevant key assumption, whilst all other assumptions are held constant. This approach does not take into account the inter-relationship between some of these assumptions or any hedging strategies adopted.

- › **Asset volatility** – if the schemes' assets underperform relative to the discount rate used to calculate the schemes' liabilities, this will create a deficit. The schemes hold some growth assets (equities, diversified growth funds and emerging market debt) which, though expected to outperform the discount rate in the long term, create volatility in the short-term. The allocation to growth assets is monitored to ensure it remains appropriate given the schemes' long-term objectives.
- › **Discount rate** – an increase/decrease in the discount rate of 0.1 per cent would have resulted in a £74.8 million (2016: £58.4 million) decrease/increase in the schemes' liabilities at 31 March 2017, although as long as credit spreads remain stable this will be largely offset by an increase in the value of the schemes' bond holdings and other instruments designed to hedge this exposure. The discount rate is based on high quality corporate bond yields of a similar duration to the schemes' liabilities.
- › **Price inflation** – an increase/decrease in the inflation assumption of 0.1 per cent would have resulted in a £70.0 million (2016: £55.3 million) increase/decrease in the schemes' liabilities at 31 March 2017, as a significant proportion of the schemes' benefit obligations are linked to inflation. However, around half of the schemes' liabilities were hedged for RPI in the external market at 31 March 2017, meaning that this sensitivity is likely to be halved as a result. In addition, around half of the schemes' liabilities were hedged through the IFM, with any change in inflation outturn resulting in a change to cash contributions provided under this mechanism. Any change in inflation outturn results in a change to the cash contributions provided under the IFM. As assumptions for pensionable salary growth and pension increases are in line with those for price inflation, sensitivities are also in line.
- › **Life expectancy** – an increase/decrease in life expectancy of one year would have resulted in a £135.3 million (2016: £92.5 million) increase/decrease in the schemes' liabilities at 31 March 2017. The majority of the schemes' obligations are to provide benefits for the life of the member and, as such, the schemes' liabilities are sensitive to these assumptions.

### Further reporting analysis

At 31 March, the fair values of the schemes' assets recognised in the statement of financial position were as follows:

Group	Schemes' assets %	2017 £m	Schemes' assets %	2016 £m
Equities	9.1	350.4	9.8	318.3
Other non-equity growth assets	4.8	185.6	9.4	304.3
Gilts	44.8	1,729.3	36.9	1,196.2
Bonds	39.8	1,537.3	41.0	1,332.7
Other	1.5	60.4	2.9	94.1
Total fair value of schemes' assets	100.0	3,863.0	100.0	3,245.6
Present value of defined benefit obligations		(3,615.5)		(2,970.4)
<b>Net retirement benefit surplus</b>		<b>247.5</b>		<b>275.2</b>

The fair values in the table above are all based on quoted prices in an active market, where applicable.

# Notes to the financial statements – appendices

## A5 Retirement benefits continued

The assets, in respect of UUPS, included in the table above, have been allocated to each asset class based on the return the assets are expected to achieve as UUPS has entered into a variety of derivative transactions to change the return characteristics of the physical assets held in order to reduce undesirable market and liability risks. As such, the breakdown shown separates the assets of the schemes to illustrate the underlying risk characteristics of the assets held.

Both of the schemes employ a strategy where the asset portfolio is made up of a growth element and a defensive element. Assets in the growth portfolio are shown as equities and other non-equity growth assets above, while assets held in the defensive portfolio represent the remainder of the schemes' assets.

The defensive element of the portfolio contains a proportion of assets set aside for collateral purposes linked to the derivative contracts entered into, as described above. The collateral portfolio, comprising cash and eligible securities readily convertible to cash, provides sufficient liquidity to manage the derivative transactions and is expected to achieve a return in excess of LIBOR.

The fair value derivatives included within pension scheme asset classification are analysed as follows:

Group	Underlying assets £m	Fair value of derivatives £m	Combined £m
<b>At 31 March 2017</b>			
Equities	320.6	29.8	350.4
Other non-equity growth assets	185.6	–	185.6
Gilts	1,729.3	–	1,729.3
Bonds	1,547.6	(10.3)	1,537.3
Other	250.5	(190.1)	60.4
<b>Total fair value of schemes' assets</b>	<b>4,033.6</b>	<b>(170.6)</b>	<b>3,863.0</b>
<b>At 31 March 2016</b>			
Equities	317.1	1.2	318.3
Other non-equity growth assets	304.3	–	304.3
Gilts	1,196.2	–	1,196.2
Bonds	1,347.2	(14.5)	1,332.7
Other	53.5	40.6	94.1
<b>Total fair value of schemes' assets</b>	<b>3,218.3</b>	<b>27.3</b>	<b>3,245.6</b>

The derivative values in the table above represent the net market value of derivatives held within each of these asset categories as follows:

- › derivatives are held within the UUPS equity portfolio to gain economic exposure equivalent to around 4.0 per cent of that scheme's assets, and comprise total return swaps on equity indices with a value of £18.2 million (2016: £1.0 million) and currency forwards with a value of £11.6 million (2016: £0.2 million);
- › derivatives are used within the UUPS bond portfolio to hedge non-sterling exposure back to sterling, and comprise credit default swaps with a value of £(10.3) million (2016: £0.4 million), interest rate swaps with a value of £nil (2016: £(15.4) million) and currency forwards with a value of £nil (2016: £0.5 million);
- › derivatives are used within both the UUPS and ESPS 'other' portfolios to manage liability risks, and comprise £(227.8) million (2016: £(9.0) million) in the UUPS and £37.7 million (2016: £49.6 million) in the ESPS. These are further broken down as follows:
  - › the UUPS has a liability hedging strategy in place, which uses a wide range of derivatives to target a high level of interest rate and inflation hedging. The net value of £(227.8) million (2016: £(9.0) million) comprises asset swaps with a value of £(132.9) million (2016: £(250.7) million), interest rate swaps with a value of £522.0 million (2016: £631.7 million), gilt repurchase agreements with a value of £(655.8) million (2016: £(377.6) million) and RPI inflation swaps with a value of £38.9 million (2016: £(12.4) million); and
  - › the ESPS has a liability hedging strategy in place, implemented using pooled funds which make use of derivatives. The value of £37.7 million (2016: £49.6 million) represents the total value of these pooled funds, i.e. underlying assets plus the value of the derivatives within these funds.

The derivatives shown in the tables only cover those expressly held for the purpose of reducing certain undesirable asset and liability risks. The schemes also invest in a number of other pooled funds that make use of derivatives. No allowance is made in the figures above for any derivatives held within these, as these are not held expressly for the purpose of managing risk. The total fair value of pooled funds held within the schemes' assets was £1,179.5 million (2016: £1,521.8 million).

## A5 Retirement benefits continued

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

Group	2017 £m	2016 £m
At the start of the year	3,245.6	3,133.7
Interest income on schemes' assets	109.4	96.3
The return on plan assets, excluding amounts included in interest	555.5	56.0
Member contributions	5.2	5.8
Benefits paid	(114.3)	(102.4)
Administrative expenses	(2.7)	(2.7)
Company contributions	64.3	58.9
<b>At the end of the year</b>	<b>3,863.0</b>	<b>3,245.6</b>

The group's actual return on the schemes' assets was a gain of £664.9 million (2016: £152.3 million), principally due to gains on derivatives hedging the schemes' liabilities.

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

Group	2017 £m	2016 £m
At the start of the year	(2,970.4)	(3,054.5)
Interest cost on schemes' obligations	(99.2)	(93.2)
Actuarial (losses)/gains arising from changes in financial assumptions	(721.4)	98.1
Actuarial gains/(losses) arising from changes in demographic assumptions	52.7	(46.6)
Actuarial gains arising from experience	36.5	52.6
Curtailments/settlements	(3.1)	(1.1)
Member contributions	(5.2)	(5.8)
Benefits paid	114.3	102.4
Current service cost	(19.7)	(22.3)
<b>At the end of the year</b>	<b>(3,615.5)</b>	<b>(2,970.4)</b>

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP), which is expected to have a widespread impact for defined benefit schemes operating in the UK. The UK Government intends to implement legislation which could result in an increase in the value of GMP for males. This would increase the defined benefit obligation of the schemes. At this stage, until the Government has further developed its proposals, it is not possible to quantify the impact of this change.

## A6 Related party transactions

### Group

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

The related party trading transactions with the group's joint ventures during the period and amounts outstanding at the period end date were as follows:

	2017 £m	2016 £m
Sales of services	404.3	1.2
Purchases of goods and services	0.7	0.7
Costs recharged at nil margin under transitional service agreements	18.5	–
Interest income and fees recognised on loans to related parties	2.6	–
Amounts owed by related parties	163.5	2.9
Amounts owed to related parties	12.1	–

Sales of services to related parties during the year mainly represent non-household wholesale charges and were on the group's normal trading terms.

# Notes to the financial statements – appendices

## A6 Related party transactions continued

At 31 March 2017, amounts owed by joint ventures, as recorded within trade and other receivables in the statement of financial position, were £163.5 million (2016: £2.9 million), comprising £41.5 million of trade balances, which are unsecured and will be settled in accordance with normal credit terms, and £122.0 million relating to loans. Included within these loans receivable were the following amounts owed by Water Plus:

- › £100.0 million outstanding on a £100.0 million revolving credit facility provided by United Utilities Water Limited, which is guaranteed by United Utilities PLC, with a maturity date of 30 September 2019, bearing a floating interest rate of LIBOR plus a credit margin;
- › £9.0 million receivable being the fair value of amounts owed in relation to a £12.5 million unsecured loan note held by United Utilities PLC, with a maturity date of 28 March 2027. This is an interest-free shareholder loan with a total amount outstanding at 31 March 2017 of £12.5 million, comprising the £9.0 million receivable held at fair value, and £3.5 million recorded as an equity contribution to Water Plus recognised within interests in joint ventures; and
- › £9.7 million outstanding on a £19.6 million unsecured amortising loan note held by United Utilities PLC, with a final maturity date of 30 November 2017, bearing a floating interest rate of LIBOR plus a credit margin. Repayments received on this loan note represent part of the proceeds received on disposal of the group's non-household retail business (see note 9).

A further £3.3 million of non-current receivables was owed by other related parties at 31 March 2017 (2016: £2.5 million).

No expense or allowance has been recognised for bad and doubtful receivables in respect of amounts owed by related parties (2016: £nil).

During the year, United Utilities PLC provided guarantees in support of Water Plus in respect of certain amounts owed to wholesalers. The aggregate limit of these guarantees was £42.5 million, of which £24.0 million related to guarantees to United Utilities Water Limited.

At 31 March 2017, amounts owed to joint ventures were £12.1 million (2016: £nil). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms (2016: £nil).

Details of transactions with key management are disclosed in note 2.

### Company

The parent company receives dividend income and pays and receives interest to and from subsidiary undertakings in the normal course of business. Total dividend income received during the year amounted to £263.1 million (2016: £258.7 million) and total net interest payable during the year was £27.7 million (2016: £27.9 million). Amounts outstanding at 31 March 2017 and 31 March 2016 between the parent company and subsidiary undertakings are provided in notes 15, 17 and 21.

At 31 March 2017 and 31 March 2016, no related party receivables and payables were secured and no guarantees were issued in respect thereof. Balances will be settled in accordance with normal credit terms. No allowance for doubtful receivables has been made for amounts owed by subsidiary undertakings as at 31 March 2017 and 31 March 2016.

## A7 Accounting policies

Of the accounting policies outlined below, those deemed to be the most significant for the group are those that align with the critical accounting judgements and key sources of estimation uncertainty set out on pages 131 to 132.

### Basis of consolidation

The group financial statements consolidate the financial statements of the company and entities controlled by the company (its subsidiaries), and incorporate the results of its share of joint ventures using the equity method of accounting. The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the date control is obtained or until the date that control ceases, as appropriate.

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

### Subsidiaries

Subsidiaries are entities controlled by the group. Control is achieved where the group is exposed to, or has the rights to, variable returns from its involvement in an entity and has the ability to affect those returns through its power over the entity. In the parent company accounts, investments are held at cost less provision for impairment.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired is credited to the income statement in the period of acquisition. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### Joint ventures

Joint ventures are entities in which the group holds an interest on a long-term basis and which are jointly controlled with one or more parties under a contractual arrangement. The group's share of joint venture results and assets and liabilities is incorporated using the equity method of accounting. Under the equity method, an investment in a joint venture is initially recognised at cost and adjusted thereafter to recognise the group's share of the profit or loss.

On losing control of a subsidiary disposed of to a joint venture, the group recognises the gain or loss attributable to measuring the investment retained in the former subsidiary at its fair value at the date when control is lost.

### Revenue recognition

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

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

### Operating profit

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

### Borrowing costs and finance income

Except as noted below, all borrowing costs and finance income are recognised in the income statement on an accruals basis.

Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument.

Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs are capitalised as part of the specific asset.

### Tax

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

#### Current tax

Current tax is based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at each reporting date.

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

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

#### Deferred tax

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

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

# Notes to the financial statements – appendices

## A7 Accounting policies continued

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at each reporting date.

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

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

### Property, plant and equipment

Property, plant and equipment comprises water and wastewater infrastructure assets and overground assets.

The useful economic lives of these assets are primarily as follows:

- › water and wastewater infrastructure assets:
  - › impounding reservoirs 200 years;
  - › mains and raw water aqueducts 30 to 300 years;
  - › sewers and sludge pipelines 60 to 300 years;
  - › sea outfalls 77 years;
- › buildings 10 to 60 years;
- › operational assets 5 to 80 years; and
- › fixtures, fittings, tools and equipment 3 to 40 years.

Employee and other related costs incurred in implementing the capital schemes of the group are capitalised.

### Water and wastewater infrastructure assets

Infrastructure assets comprise a network of water and wastewater pipes and systems. Expenditure on the infrastructure assets, including borrowing costs where applicable, relating to increases in capacity or enhancements of the network is treated as additions. Amounts incurred in maintaining the operating capability of the network in accordance with defined standards of service are expensed in the year in which the expenditure is incurred. Infrastructure assets are depreciated by writing off their cost (or deemed cost for infrastructure assets held on transition to IFRS), less the estimated residual value, evenly over their useful economic lives.

### Other assets

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

Historical cost includes expenditure that is directly attributable to the acquisition of the items, including relevant borrowing costs, where applicable, for qualifying assets. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All

other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Freehold land and assets in the course of construction are not depreciated. Other assets are depreciated by writing off their cost, less their estimated residual value, evenly over their estimated useful economic lives, based on management's judgement and experience.

Depreciation methods, residual values and useful economic lives are reassessed annually and, if necessary, changes are accounted for prospectively. The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in other operating costs.

### Transfer of assets from customers and developers

Where the group receives from a customer or developer an item of property, plant and equipment (or cash to construct or acquire an item of property, plant and equipment) that the group must then use, either to connect the customer to the network, or to provide the customer with ongoing access to a supply of goods or services, or to do both, such items are capitalised at their fair value and included within property, plant and equipment, with a credit of the same amount to deferred grants and contributions. The assets are depreciated over their useful economic lives and the deferred contributions released to revenue over the same period (or where the receipt of property, plant and equipment is solely to connect the customer to the network, the deferred contribution is released immediately to revenue). This interpretation has been applied to transfers of assets from customers received on or after 1 July 2009.

Assets transferred from customers or developers are accounted for at fair value. If no market exists for the assets then incremental cash flows are used to arrive at fair value.

### Intangible assets

Intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful economic lives. The carrying amount is reduced by any provision for impairment where necessary. On a business combination, as well as recording separable intangible assets already recognised in the statement of financial position of the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the acquisition statement of financial position at fair value.

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

Intangible assets, which relate primarily to computer software, are amortised over a period of three to ten years.

### Impairment of tangible and intangible assets

Intangible assets and property, plant and equipment are reviewed for impairment at each reporting date to determine whether there is any indication that those assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate

cash flows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs.

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

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

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

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

Non-current assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

### **Financial instruments**

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

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

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

#### *Financial investments*

Investments (other than interests in subsidiaries, joint ventures and fixed deposits) are initially measured at fair value, including transaction costs. Investments classified as available for sale in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or

loss previously recognised in equity is included in the net profit or loss for the period.

#### *Trade receivables*

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

#### *Trade payables*

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

#### *Financial liabilities and equity*

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

#### *Equity instruments*

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

#### *Borrowings*

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

The default treatment of measuring at amortised cost, whilst associated hedging derivatives are recognised at fair value, presents an accounting measurement mismatch that has the potential to introduce considerable volatility to both the income statement and the statement of financial position. Therefore, where feasible, the group takes advantage of the provisions under IAS 39 'Financial Instruments: Recognition and Measurement' to make fair value adjustments to its borrowing instruments to reduce this volatility and better represent the economic hedges that exist between the group's borrowings and associated derivative contracts.

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

#### *Borrowings designated within a fair value hedge relationship*

Where designated, bonds and loans are initially measured at fair value being the cash proceeds received net of any direct issue costs. They are subsequently adjusted for any change in fair value attributable to the risk being hedged at each reporting date, with the change being charged or credited to finance expense in the income statement.

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

# Notes to the financial statements – appendices

## A7 Accounting policies 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 finance expense in the income statement.

### *Derivative financial instruments*

Derivative financial instruments are measured at fair value at each reporting date, with changes in fair value being charged or credited to finance expense in the income statement. The group enters into financial derivatives contracts to manage its financial exposure to changes in market rates (see note A4).

### *Derivatives and borrowings – valuation*

Where an active market exists, designated borrowings and derivatives recorded at fair value are valued using quoted market prices. Otherwise, they are valued using a net present value valuation model. The model uses applicable interest rate curve data at each reporting date to determine any floating cash flows. Projected future cash flows associated with each financial instrument are discounted to the reporting date using discount factors derived from the applicable interest curves adjusted for counterparty credit risk where appropriate. Discounted foreign currency cash flows are converted into sterling at the spot exchange rate at each reporting date. Assumptions are made with regard to credit spreads based on indicative pricing data.

The valuation of debt designated in a fair value hedge relationship is calculated based on the risk being hedged as prescribed by IAS 39 'Financial Instruments: Recognition and Measurement'. The group's policy is to hedge its exposure to changes in the applicable underlying interest rate and it is this portion of the cash flows that is included in the valuation model (excluding any applicable company credit risk spread).

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

## **Inventories**

Inventories are stated at the lower of cost and net realisable value. For properties held for resale, cost includes the cost of acquiring and developing the sites, including borrowing costs where applicable.

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

## **Employee benefits**

### *Retirement benefit obligations*

The group operates two defined benefit pension schemes, which are independent of the group's finances, for its employees. Actuarial valuations to determine the funding of the schemes, along with future contribution rates, are carried out by the

pension scheme actuary as directed by the trustees at intervals of not more than three years. In any intervening years, the trustees review the continuing appropriateness of the funding and contribution rates.

From a financial reporting perspective and in accordance with IAS 19, defined benefit assets are measured at fair value while liabilities are measured at present value, using the projected unit credit method. The difference between the two amounts is recognised as a surplus or obligation in the statement of financial position. Where this difference results in a defined benefit surplus this is recognised in accordance with IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction' on the basis that the group has an unconditional right to a refund of any surplus that may exist following the full settlement of plan liabilities in a single event.

The cost of providing pension benefits to employees relating to the current year's service (including curtailment gains and losses) is included within employee benefits expense, while the interest on the schemes' assets and liabilities is included within investment income and finance expense respectively. Remeasurement gains/losses on scheme assets and liabilities are presented in other comprehensive income.

In addition, the group also operates a defined contribution pension section within the United Utilities Pension Scheme. Payments are charged as employee costs as they fall due. The group has no further payment obligations once the contributions have been paid.

### *Share-based compensation arrangements*

The group operates equity-settled, share-based compensation plans, issued to certain employees. The equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on estimates of the number of options that are expected to vest. Fair value is based on simulation models, according to the relevant measures of performance. The group has the option to settle some of these equity-settled share-based payments in cash.

At each reporting date, the group revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

## **Provisions**

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

## **Foreign currency translation**

### *Transactions and balances*

Transactions in foreign currencies are recorded at the exchange rates applicable on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in

foreign currencies are translated into sterling at the relevant rates of exchange applicable on that date. Gains and losses arising on retranslation are included in net profit or loss for the period.

Exchange differences arising on investments in equity instruments classified as available for sale are included in the gains or losses arising from changes in fair value which are recognised directly in equity. In order to hedge its exposure to certain foreign exchange risks, the group enters into derivative instruments (see note A4).

#### *Group companies*

On consolidation, the statements of financial position of overseas subsidiaries and joint ventures (none of which has the currency of a hyperinflationary economy) are translated into sterling at exchange rates applicable at each reporting date. The income statements are translated into sterling using the average rate unless exchange rates fluctuate significantly, in which case the exchange rate at the date the transaction occurred is used.

Exchange differences resulting from the translation of such statements of financial position at rates ruling at the beginning and end of the period, together with the differences between income statements translated at average rates and rates ruling at the period end, are dealt with as movements on the group's cumulative exchange reserve, a separate component of equity. Such translation differences are recognised as income or expense in the period in which the operation is disposed of.

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

#### **Grants and contributions**

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

#### **Leases**

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

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

# Notes to the financial statements – appendices

## A8 Subsidiaries and other group undertakings

Details of the group's subsidiary undertakings, joint ventures and associates are set out below. Unless otherwise specified, the registered address for each entity is Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP, United Kingdom. For further details of joint ventures and associates please see notes 12 and 13.

	Class of share capital held	Proportion of share capital owned/voting rights %*	Nature of business
<i>Subsidiary undertakings</i>			
<b>Great Britain</b>			
Halkyn District Mines Drainage Company Limited	Ordinary	99.9	Dormant
North West Water International Limited	Ordinary	100.0	Holding company for international business
North West Water Limited	Ordinary	100.0	Dormant
United Utilities (Overseas Holdings) Limited	Ordinary	100.0	Holding company
United Utilities Energy Limited	Ordinary	100.0	Energy generation
United Utilities Healthcare Trustee Limited	Ordinary	100.0	Corporate trustee
United Utilities International Limited	Ordinary	100.0	Consulting services and project management
United Utilities North West Limited	Ordinary	100.0	Holding company
United Utilities Operational Services Limited	Ordinary	100.0	Operations and maintenance contract holder
United Utilities Pensions Trustees Limited	Ordinary	100.0	Corporate trustee
United Utilities PLC	Ordinary	100.0	Holding and management company
United Utilities Property Services Limited	Ordinary	100.0	Property management
United Utilities Renewable Energy Limited	Ordinary	100.0	Renewable energy generation
United Utilities Total Solutions Limited	Ordinary	100.0	Water and wastewater services
United Utilities Utility Solutions (Industrial) Limited	Ordinary	100.0	Holding company
United Utilities Utility Solutions Holdings Limited	Ordinary	100.0	Holding company
United Utilities Water Finance PLC	Ordinary	100.0	Financing company
United Utilities Water Limited	Ordinary	100.0	Water and wastewater services
United Utilities Water Operations Holdings Limited	Ordinary	100.0	Holding company
UU (ESPS) Pension Trustee Limited	Ordinary	100.0	Corporate trustee
UU Group Limited	Ordinary	100.0	Dormant
UU Secretariat Limited	Ordinary	100.0	Dormant
YCL Transport Limited	Ordinary	100.0	Non-trading
United Utilities Bioresources Limited	Ordinary	100.0	Wastewater services
<b>The Netherlands</b>			
United Utilities (Tallinn) BV	Ordinary	100.0	Holding company
<b>Thailand</b>			
Manta Management Services Limited <sup>(1)</sup>	Ordinary	49.0	Management company
Water Resources Limited <sup>(1)</sup>	Ordinary	100.0	Non-trading
<i>Joint ventures</i>			
<b>Great Britain</b>			
Lingley Mere Business Park Development Company Limited	Ordinary	50.0	Development company
Lingley Mere Management Company Limited	Ordinary	50.0	Property management
Selectusonline Limited	Ordinary	16.7	Procurement portal
Water Plus Group Limited <sup>(2)</sup>	Ordinary	50.0	Holding company
<b>Estonia</b>			
AS Tallinna Vesi <sup>(3)</sup>	Ordinary	35.3	Water and wastewater services

**A8 Subsidiaries and other group undertakings** continued

	Class of share capital held	Proportion of share capital owned/voting rights %*	Nature of business
<i>Associated undertakings</i>			
<b>Bahrain</b>			
Muharraq STP Company BSC(c) <sup>(4)</sup>	Ordinary	20.0	Project company
Muharraq Wastewater Services Company WLL <sup>(4)</sup>	Ordinary	35.0	Operations and maintenance company
<b>Jebel Ali Free Zone, Dubai, UAE</b>			
Muharraq Holding Company 1 Limited <sup>(5)</sup>	Ordinary	20.0	Holding company

\* With the exception of United Utilities PLC, shares are held by subsidiary undertakings rather than directly by United Utilities Group PLC.

Notes:

- (1) Registered address: 4th Floor, Iyara Building Room 405, 2/22 Chan Road, Thung Wat Don Sub-district, Sathon District, Bangkok, 10120 Thailand.
- (2) Registered address: Two Smithfield, Leonard Coates Way, Stoke-on-Trent, United Kingdom, ST1 4FD.
- (3) Registered address: Adala 10, Tallinn 10614, Estonia.
- (4) Registered address: Building 200, Road 13, Block 115, Hidd, Kingdom of Bahrain.
- (5) Registered address: Al Tamimi & Company, 9th Floor, Dubai World Trade Centre, Sheikh Zayed Road, Dubai, United Arab Emirates.

## Five-year summary – unaudited

The financial summary (unaudited) set out below has been derived from the audited consolidated financial statements of United Utilities Group PLC for the five years ended 31 March 2017. It should be read in conjunction with the consolidated financial statements and related notes, together with the strategic report.

Year ended 31 March	2017	2016	2015	2014	2013
Continuing operations	£m	£m	£m	£m	£m
Revenue	<b>1,704.0</b>	1,730.0	1,720.2	1,688.8	1,636.0
Operating profit per reported results	<b>605.5</b>	567.9	653.3	630.2	601.6
Underlying operating profit	<b>622.9</b>	604.1	664.3	634.6	604.2
Profit before tax per reported results	<b>442.4</b>	353.5	341.6	543.3	311.8
Underlying profit before tax	<b>389.4</b>	408.1	447.4	388.1	351.4
Profit after taxation per reported results	<b>433.9</b>	397.5	271.2	738.6	287.8
Underlying profit after tax	<b>313.4</b>	325.3	354.1	304.9	264.2
Earnings per share (basic) per reported results (pence)	<b>63.6p</b>	58.3p	39.8p	108.3p	42.2p
Underlying earnings per share (pence)	<b>46.0p</b>	47.7p	51.9p	44.7p	38.7p
Dividend per ordinary share (pence)	<b>38.87p</b>	38.45p	37.70p	36.04p	34.32p
Non-current assets	<b>11,768.2</b>	11,280.8	10,664.8	9,929.6	9,777.8
Current assets	<b>657.9</b>	626.0	638.8	542.9	630.2
Total assets	<b>12,426.1</b>	11,906.8	11,303.6	10,472.5	10,408.0
Non-current liabilities	<b>(8,914.7)</b>	(8,357.1)	(7,867.7)	(7,660.3)	(7,845.8)
Current liabilities	<b>(689.8)</b>	(844.2)	(1,001.5)	(596.3)	(690.3)
Total liabilities	<b>(9,604.5)</b>	(9,201.3)	(8,869.2)	(8,256.6)	(8,536.1)
Total net assets and shareholders' equity	<b>2,821.6</b>	2,705.5	2,434.4	2,215.9	1,871.9
Net cash generated from operating activities	<b>820.8</b>	685.6	706.5	797.2	631.1
Net cash used in investing activities	<b>(804.6)</b>	(676.8)	(704.9)	(678.6)	(643.8)
Net cash (used in)/generated from financing activities	<b>22.0</b>	(46.4)	139.2	(211.5)	(115.5)
Net (decrease)/increase in cash and cash equivalents	<b>38.2</b>	(37.6)	140.8	(92.9)	(128.2)
Net debt	<b>6,578.7</b>	6,260.5	5,924.0	5,519.9	5,450.6
RCV gearing <sup>(1)</sup> (%)	<b>61%</b>	61%	59%	58%	60%

Note:

(1) Regulatory capital value (RCV) gearing is calculated as group net debt (see note A2), divided by the RCV expressed in outturn prices, of United Utilities Water Limited.



# Shareholder information

## Key dates

- **22 June 2017**  
Ex-dividend date for 2016/17 final dividend
- **23 June 2017**  
Record date for 2016/17 final dividend
- **28 July 2017**  
Annual general meeting
- **4 August 2017**  
Payment of 2016/17 final dividend to shareholders
- **22 November 2017**  
Announcement of half-year results for the six months ending 30 September 2017
- **21 December 2017**  
Ex-dividend date for 2017/18 interim dividend
- **22 December 2017**  
Record date for 2017/18 interim dividend
- **1 February 2018**  
Payment of 2017/18 interim dividend to shareholders
- **May 2018**  
Announce the final results for the 2017/18 financial year
- **June 2018**  
Publish the annual report and financial statements for the 2017/18 financial year

## Why not make life easy and have your dividends paid straight to your bank?

- › The dividend goes directly into your bank account and is available straight away
- › No need to pay dividend cheques into your bank account
- › No risk of losing cheques in the post
- › No risk of having to replace spoiled or out-of-date cheques
- › It's cost-effective for your company

To take advantage of this, please contact Equiniti via [shareview.co.uk](http://shareview.co.uk) or complete the dividend mandate form that you receive with your next dividend cheque.

If you choose to have your dividend paid directly into your bank account you'll receive one tax voucher each year. This will be issued with the interim dividend normally paid in February and will contain details of all the dividends paid in that tax year. If you'd like to receive a tax voucher with each dividend payment, please contact Equiniti.



Go to Equiniti for more information via [shareview.co.uk](http://shareview.co.uk)

## Electronic communications

We're encouraging our shareholders to receive their shareholder information by email and via our website. Not only is this a quicker way for you to receive information, it helps us to be more sustainable by reducing paper and printing materials and lowering postage costs.

Registering for electronic shareholder communications is very straightforward, and is done online via [shareview.co.uk](http://shareview.co.uk) which is a website provided by our registrar, Equiniti.

Log on to [shareview.co.uk](http://shareview.co.uk) and you can:

- › set up electronic shareholder communication;
- › view your shareholdings;
- › update your address details if you change your address; and
- › get your dividends paid directly into your bank account.

Please do not use any electronic address provided in this notice or in any related document to communicate with the company for any purposes other than those expressly stated.

## Online annual report

Our annual report is available online. View or download the full annual report and financial statements from: [unitedutilities.com/corporate](http://unitedutilities.com/corporate)



## Keeping you in the picture

You can find information about United Utilities quickly and easily on our website: [corporate.unitedutilities.com](http://corporate.unitedutilities.com) Here the annual report and financial statements, responsible business performance, company announcements, the half-year and final results and presentations are published.

### Registrar

The group's registrar, Equiniti, can be contacted on: **0371 384 2041** or textphone for those with hearing difficulties: **0371 384 2255**. Lines are open 8.30 am to 5.30 pm, Monday to Friday excluding public holidays.

The address is:

Equiniti, Aspect House, Spencer Road,  
Lancing, West Sussex, BN99 6DA.

Overseas shareholders may contact them on:  
**+44 (0)121 415 7048**

Equiniti offers a share dealing service by telephone:

**0345 603 7037** and online:

[shareview.co.uk/dealing](http://shareview.co.uk/dealing)

Equiniti also offers a stocks and shares ISA for United Utilities shares, call **0345 300 0430** or go to: [shareview.co.uk/dealing](http://shareview.co.uk/dealing)

## Looking after your investment

Our approach to responsible business has again helped us retain world class status in the Dow Jones Sustainability Index for the ninth consecutive year and membership of FTSE4Good Index for the fifteenth. We also received a B rating in the Carbon Disclosure Project and secured 90 per cent in BitC's CR Index.



This document is printed on Cocoon Silk 100 which is made from 100% FSC® Recycled pulp and post-consumer waste paper. This reduces waste sent to landfill, greenhouse gas emissions, as well as the amount of water and energy consumed.



## Important information

### Cautionary statement:

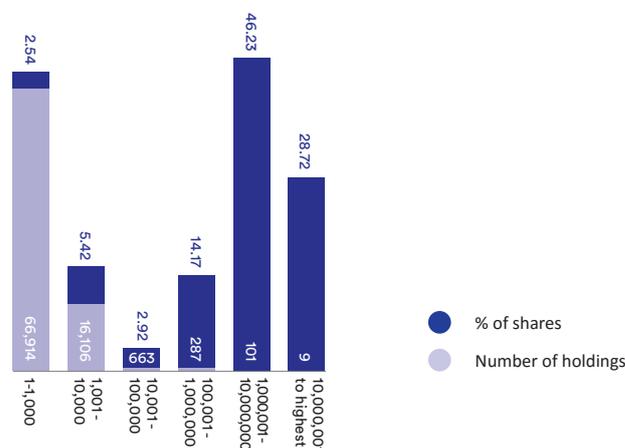
The annual report and financial statements (the annual report) contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and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

### Terms used in this report:

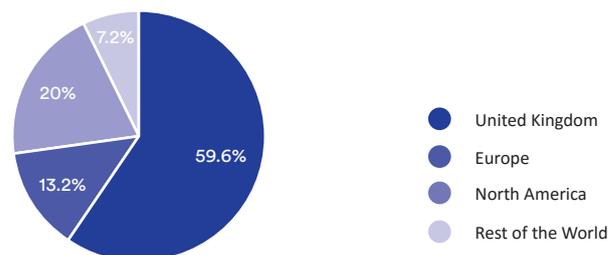
Unless expressly stated otherwise, the 'group', 'United Utilities', 'UU' or 'the company' means United Utilities Group PLC and its subsidiary undertakings; the 'regulated business', 'regulated activities' or 'UUW' means the licensed water and wastewater activities undertaken by United Utilities Water Limited (formerly United Utilities Water PLC) in the North West of England.

## Key shareholder facts

Balance analysis as at 31 March 2017



## Shareholders by location



## Dividend history – pence per share

	2013	2014	2015	2016	2017
Interim	11.44	12.01	12.56	12.81	12.95
Final	22.88	24.03	25.14	25.64	25.92
Total ordinary	34.32	36.04	37.70	38.45	38.87

## Warning to shareholders

Please be very wary of any unsolicited contact about your investments or offers of free company reports. It may be from an overseas 'broker' who could sell you worthless or high risk shares. If you deal with an unauthorised firm, you would not be eligible to receive payment under the Financial Services Compensation Scheme. Further information and a list of unauthorised firms that have targeted UK investors is available from the Financial Conduct Authority at: [fca.org.uk/consumers/protect-yourself/unauthorised-firms](http://fca.org.uk/consumers/protect-yourself/unauthorised-firms)



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