Registered No: 2366678

United Utilities Water PLC

Report and Financial Statements

31 March 2011

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Directors, advisers and other information

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

Executive directors
JR Houlden
SL Mogford

Secretary
SR Gardiner

Auditor
Deloitte LLP
2 Hardman Street
Manchester
M60 2AT

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

Business description

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

UUW is a subsidiary of United Utilities North West PLC. The ultimate parent company of United Utilities Water PLC is United Utilities Group PLC (which, together with its subsidiaries, constitutes 'the group').

United Utilities Group PLC is the UK's largest listed water business. The group owns and manages the regulated water and wastewater network in the North West of England.

Key facts

- 96 water treatment works
- Over 42,000 kilometres of water pipes
- 57,000 hectares of catchment land
- 575 wastewater treatment works
- Over 43,000 kilometres of sewers
- Serving a population of seven million people

UUW holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England. Almost 2,000 million litres of water is supplied every day to approximately 3.2 million homes and businesses. Water is collected from catchment land and other sources and stored in reservoirs before being treated and then delivered via a network of pipes to homes and industry. A large proportion of the water supplied flows freely by gravity and does not need to be pumped.

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

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

Since privatisation in 1990:

- Water quality in the North West has improved from 99.6 per cent to 99.9 per cent;
- Compliance with bathing water standards across the North West has risen from just over 30 per cent to more than 90 per cent;
- Leakage from the network has halved, supported by ongoing investment in replacing ageing water pipes; and
- UUW has invested more than £4,000 for every household in the North West, which is above the national average.

In the 2005–10 period, UUW invested more than £3 billion to improve the water and wastewater infrastructure and the environment across the North West. Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive and the revised Drinking Water Directive).

Business description (continued)

Consistent with the group's approach to longer-term planning, UUW's strategic direction statement, updated in April 2010, sets out the company's plans for the 2010–15 regulatory period in a longer-term context. The key elements identified in the strategic direction statement are:

- Responsible stewardship of water and wastewater networks;
- Listening to customers and other stakeholders;
- Ensuring water resources are more sustainable and resilient;
- An integrated approach to drainage to reduce the threat of flooding;
- Reducing significantly the carbon impact of activities; and
- Bills to rise, on average, no faster than incomes.

The group has a well-established framework for risk management and climate change is identified as one such risk. As such, climate change is managed in the same way as any other risk to the group. In January 2011, UUW published its response to the Secretary of State for Environment, Food and Rural Affairs, detailing the work already undertaken and the company's plans to adapt to the challenge of climate change, in line with the requirements under the Climate Change Act 2008.

Regulatory environment

Environmental regulation is the responsibility of the Secretary of State for Environment, Food and Rural Affairs together with the Environment Agency, the Drinking Water Inspectorate and Natural England.

Economic regulation is the responsibility of an independent body, Ofwat, which sets price limits every five years for the water sector in England and Wales. Price cap regulation in the UK is performance based and companies are incentivised to be efficient in terms of their operating costs, capital programmes and financing. Regulated revenue is set by reference to inflation as measured by the retail prices index (RPI) plus an adjustment factor known as 'K'.

Current price limits were published in 2009 when Ofwat set out its final determination of price limits for the period 1 April 2010 to 31 March 2015. UUW's profile of price limits for the five years is set out below.

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

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

- a £3.6 billion capital investment programme (2007/08 prices);
- 12 per cent, or approximately £900 million, real growth in the regulatory capital value (RCV) over the five year period;
- an average annual underlying operating efficiency of 1.2 per cent for the water service and 2.4 per cent for the wastewater service; and
- a return on capital of 4.5 per cent (post-tax, real).

The RCV is the capital base on which water companies earn a return. It is increased by capital expenditure and inflation, and reduced by depreciation.

Chairman’s and chief executive officer’s statement

Overview

In line with group’s strategy of focusing on core activities, the United Utilities Group (“United Utilities”) completed its non-regulated disposal programme in November 2010. The last four years have seen United Utilities reshape its portfolio from a group with a wide ranging set of activities and interests into a regulated UK water and wastewater business.

We believe this enhanced focus on the regulated business will enable us to deliver further operational performance, customer service and efficiency improvements. We remain confident of delivering outperformance over the 2010–15 period, with significant financing outperformance already secured.

We have made good progress in the first year of the new five-year regulatory period and are pleased to report a sound set of financial results. We have continued to make high levels of investment in our water and wastewater assets providing further benefits for our shareholders, customers and the environment.

Operational performance

We continue to work hard to improve our operational performance and have made further progress during the year. We are pleased that more customers than ever before are telling us that they are satisfied or very satisfied with our service and we have achieved an overall customer satisfaction rate of 83 per cent for 2010/11. In addition, this year we reduced by over three quarters the number of customer complaints assessed by the Consumer Council for Water. We know, however, that there is still more we can do in this area and it remains a key priority for us.

The commitment demonstrated by our employees during the unprecedented cold spell that we experienced in December 2010 was exemplary. This outstanding effort has resulted in us achieving Ofwat’s leakage target for a fifth consecutive year. This is a remarkable achievement given the significant impact of the extreme weather on our leakage levels and we would like to take this opportunity to say thank you to all our employees and contractors who worked tirelessly to achieve this result.

In order to enhance further the visibility of our operational performance and help drive continuous improvements, we have reviewed our key performance indicators (KPIs) against which our stakeholders can assess our progress. As part of our aim to deliver best service to customers, we will continue to measure asset serviceability and customer satisfaction, and intend to introduce Ofwat’s new service incentive mechanism (SIM) when fully implemented. Our drive to deliver lowest sustainable cost will be supported through our KPIs which cover relative efficiency and water leakage. We also have KPIs to measure environmental performance and corporate responsibility.

Delivering our regulatory contract

We have made a good start to the new regulatory period and investment in our assets has continued at high levels, helping the business meet strict environmental standards and deliver an improved service for our customers. Regulatory capital expenditure, including infrastructure renewals expenditure, in our water and wastewater business amounted to over £600 million during the year. This substantial level of spend is consistent with our planned investment programme over the 2010–15 period, as we aim to smooth the spend profile to optimise efficiency and reduce risk. We are pleased to have made good early progress in the delivery of outputs.

Chairman’s and chief executive officer’s statement (continued)

Corporate governance and corporate responsibility

We have consistently demonstrated a commitment to adopting the highest standards of corporate governance at board level and throughout the company. The board closely monitors new developments and requirements in this area.

In light of the group’s strategic focus on its core water activities, we have simplified the board structure such that directors’ membership of the United Utilities Group PLC and United Utilities Water PLC boards is now identical.

We continue to listen to the views of all our stakeholders and endeavour to develop, manage and operate in an environmentally sustainable and socially responsible manner. This includes a continued focus on water efficiency, the impact of climate change and responding to the needs of our customers.

In recognition of the group’s continued focus on corporate responsibility, it retained its ‘World Class’ rating, as measured by the Dow Jones Sustainability Index.

Health and safety is paramount and we believe that everybody in United Utilities has a part to play in maintaining a safe working environment. We acknowledge that our health and safety performance in 2010/11 has been below our target and we will continue to focus on this area.

Regulatory developments

Privatisation of the water industry has generally been considered a success, with companies having invested over £90 billion to maintain and improve assets, customer service and the environment. Some 20 years after privatisation, there are currently a number of reviews being undertaken to assess options for the future development of the industry. This includes a UK Government review of Ofwat and a Water White Paper is expected to be published later this year.

Whilst it is too early for us to know the outcome of the various reviews that are taking place, we will continue to work very closely with the key politicians and regulators to represent the best interests of our investors, customers, broader stakeholders and the industry as a whole.

People

The people in United Utilities are key to the delivery of the highest levels of service to our customers and we would like to thank them for their dedication and continued hard work. We believe that a committed and motivated workforce is central to delivering our vision to become the UK’s leading water company and we remain fully focused on maintaining high levels of employee engagement.

On behalf of the board, we say thank you and farewell to Philip Green who has made a tremendous contribution to United Utilities during the last five years. Philip led the reshaping of the company’s strategy and capital structure and he leaves United Utilities on a sound footing. We wish him all the best in his future challenges.

We welcome Russ Houlden who joined us in October from Telecom New Zealand as chief financial officer. His combination of experience within finance and treasury will prove invaluable to the company, along with his extensive experience of operating in a regulatory environment and managing large capital expenditure programmes.

Chairman’s and chief executive officer’s statement (continued)

Environment

Key to the group’s strategic objectives is the goal to operate in a more sustainable manner. Given our long life assets, we take a long-term view of our operations. In line with requirements under the Climate Change Act 2008, in January 2011, we published our response to the Secretary of State for Environment, Food and Rural Affairs detailing the work we are already undertaking and the plans we are putting into place to adapt to the challenge of climate change. We continue to look at ways of reducing demand for water to help ensure the continuity of water supplies for our customers.

We recently completed the construction of our West East Link water pipeline, which will enable us to transport water over 55 kilometres in either direction between Merseyside and Greater Manchester. This is one of the largest projects of its kind ever undertaken and upon commissioning will improve further our ability to manage water supply across our region and therefore our resilience to climate change.

Customers

During 2010/11 our household customers have benefited from an average real reduction in their water bills of 4.3 per cent, which equates to around £16 per customer per annum. Despite this reduction in average customer bills, we have continued to invest heavily in our assets in order to ensure that we can continue to provide our customers with high quality drinking water to meet all their daily needs and environmentally responsible wastewater collection and treatment.

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

Outlook

We believe that, with the continued focus on the core regulated activities, we are well positioned to meet the challenges of the current regulatory period and beyond, with the aim of delivering benefits for all of our stakeholders. The board is encouraged by the progress we have made in the first year of the new regulatory period and is confident we can build on this as we progress through the remainder of the period. We hope our shareholders, employees and customers will continue to share in United Utilities’ success.

JDG McAdam
Chairman
30 June 2011

SL Mogford
Chief executive officer
30 June 2011

Business review

Financial performance

Turnover has decreased by 4.1 per cent to £1,485.5 million, principally reflecting the impact of the 2009 price review, which includes a 4.0 per cent nominal price decrease for 2010/11. Customers are benefiting from lower prices alongside significant investment in United Utilities' water and wastewater infrastructure, which helps meet strict environmental standards and deliver an improved service. As anticipated, regulated revenue was a little lower in the second half of 2010/11 compared with the first half, reflecting seasonality.

Operating profit for the year decreased by 25.4 per cent. This was primarily a result of the regulated price reduction and expected increases in depreciation, infrastructure renewals expenditure and property rates, partly offset by a reduction in power costs. Other operating expenses were impacted by increases in legal provisions and several small non-recurring items. In line with the planned phasing of the capital investment programme, infrastructure renewals expenditure and depreciation were higher in the second half of 2010/11 compared with the first half of the year. Operating profit was also impacted by one-off costs of £11.9 million which principally reflect business restructuring. The comparatives include a one-off pensions credit of £76.7 million.

Net interest payable of £254.0 million was £95.3 million lower than the prior year, principally reflecting £15.1 million of fair value gains on debt and derivative instruments, compared with £138.4 million of fair value losses in 2009/10. The impact of credit spreads on debt accounted for at fair value through profit or loss has contributed to the net fair value movement on the prior year. In addition, the net pension interest expense was £11.4 million lower than the prior year due to a higher return on the scheme's assets. Partially offsetting the favourable variances above, is an increase of £72.0 million on the prior year from indexation of the principal on index-linked debt primarily due to the effects of RPI deflation in the prior year on the debt with an eight-month lag. The principal indexation uplift does not represent a cash flow during the year and is more than matched by an inflationary uplift to the regulatory capital value.

The current tax charge for 2010/11 was £42.9 million and the current tax effective rate was 12.9 per cent, compared with 13.9 per cent in the prior year. The current tax charge included a £26.1 million credit in relation to the amendment of prior years' tax returns. The remaining reduction from the UK rate of 28% mainly relates to an increase in accelerated tax allowances and the timing difference is matched by an equal and opposite movement in deferred tax.

The deferred tax charge was £11.3 million compared to a £22.0 million credit in the prior year. The principal reasons for the difference are the movement in the discount for deferred tax and the current year adjustment for the change in tax rate together with movements in relation to prior year adjustments and the prior year tax credit on exceptional items.

Net debt including derivatives increased by £215.8 million to £5,166.5 million at 31 March 2011. As expected, RCV gearing, measured as these borrowings divided by the regulatory capital value, decreased to 63.2 per cent compared with 64.4 per cent at 31 March 2010.

In 2010/11 interim dividends amounting to £262.2 million were declared and paid (2010: interim dividend of £231.2 million declared and paid during 2010). No final dividend has been recommended for 2010/11 (2010: £nil).

UUW has made changes to its approach to revenue recognition, with effect from 1 April 2010, which it believes best reflect the likelihood of cash collection. This revised approach is consistent with FRS 5 Application Note G 'Revenue Recognition' and reflects better information regarding which customers are not likely to pay. The effect has been to reduce both revenue and the bad debt charge in the income statement, with a minimal impact on operating profit.

Business review (continued)

Regulatory accounts measures

Atypical and exceptional operating expenditure items

Atypical items have been identified and disclosed in the regulatory accounts in accordance with the requirements of Regulatory Accounting Guidelines which are different from the requirements of UK accounting standards in relation to 'Exceptional items'.

The net atypical operating expenditure/(income) items are as below:

	2011 £m	2010 £m
Legal provisions	7.3	2.0
Other reorganisation costs [(1)]	7.0	-
Write off of debt deemed uneconomical to collect	3.3	-
Pension schemes' curtailment losses arising on reorganisation [(1)]	2.8	-
Costs associated with the summer 2010 drought	2.4	-
Severance related restructuring costs [(1)]	2.1	15.8
Costs associated with the winter 2010 freeze/thaw	1.8	-
Costs associated with the Wirral flooding	1.6	-
Pension schemes curtailment gains arising on amendment of pension obligations	-	(76.7)
Credit adjustment to the wastewater business rates growth accrual covering the period from 1 April 2005	-	(7.8)
Restoration costs incurred to support the clean up of Cumbrian region after floods	-	1.4
	28.3	(65.3)

[(1)] The total of other reorganisation costs, pension schemes' curtailment losses arising on reorganisation and severance related restructuring costs is £11.9 million (see note 3 on page 50).

Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation

The annual infrastructure renewals charge is based on infrastructure renewals spend for 2010/11, the Company Business Plan for Asset Management Plan (AMP) 5 and the Final Business Plan projections for AMP 6 and AMP 7 covering the period 2010 to 2025. The charge for the year ended 31 March 2011 is £140.3 million (2010: £109.1 million).

The current cost depreciation charge (net of deferred credits) for the year is £387.6 million (2010: £339.8 million). This increase of £47.8 million is due to the increase in the depreciable asset base from commissioned capital expenditure and the RPI uplift, the AMP revaluation adjustment posted at 31 March 2010 and the impact of a change in mechanical and electrical asset lives with effect from 1 April 2010.

Donations to charitable trusts assisting customers or similar funds

During the year, the company has made donations of £5.0 million (2010: £3.0 million) to the United Utilities Trust Fund, an independent charitable trust helping customers in genuine financial difficulty with both water and non-water debts and in addition providing monies to third parties to promote money advice work.

This is in line with the agreed donation profile and has been expensed via the profit and loss account.

Business review (continued)

Performance against KPIs

The company monitors a large number of financial and non-financial KPIs, including targets set by Ofwat. Performance in 2010/11 against these measures is set out in the table below, together with the prior year performance data.

	2011	2010
Financial KPIs		
Turnover [(1)]	£1,485.5m	£1,549.2m
Operating profit	£587.8m	£788.0m
Profit before tax	£333.8m	£438.7m
RCV gearing [(2)]	63%	64%
Interest cover [(3)]	2.2	3.2
Non-financial KPIs		
Best service to customers		
Serviceability [(4)]	4 x stable	4 x stable
Overall customer satisfaction (in response to enquiries)	83%	82%
Lowest sustainable cost		
Water – relative efficiency banding [(5)]	Band B	Band B
Wastewater – relative efficiency banding [(5)]	Band C	Band C
Leakage – rolling annual average leakage	464Ml/day	461Ml/day
Responsible manner		
Environment Agency performance assessment [(6)]	6th	10th

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

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

[(3)] Interest cover is the number of times the net underlying finance expense is covered by operating profit before exceptional charges. Net underlying interest expense is calculated as the underlying cost of borrowings excluding any pension adjustment and movements in the fair value of debt and derivatives but including the £9.5 million (2010: £29.7 million) interest on swaps and debt under fair value option.

[(4)] Ofwat rates assets as improving, stable, marginal or deteriorating and classes them between water and wastewater and infrastructure and non-infrastructure.

[(5)] Bandings relate to 2009/10 and 2008/09 being the latest available assessments (2009/10 bandings based on internal company modelling).

[(6)] Composite index produced by the Environment Agency, which measures the relative performance of the 10 water and sewerage companies. Performance relates to 2009/10 and 2008/09 being the latest available assessments.

Business review (continued)

Business objectives and performance

Operational performance

The company aims to deliver long-term shareholder value by providing:

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

Operational performance is a top priority for the company and it aims to deliver improvements in this area and outperform its regulatory contract. The business also has a range of key performance indicators to enhance the visibility of its performance and help drive improvements.

Best service to customers

Actions:

Customer experience – UUW has established a customer experience programme to help deliver improved customer service. The business now offers additional contact options for customers, such as an online account management facility, to provide more choices as to when and how they can contact the company. A priority is to improve customer data management to ensure this provides a single view of the customer to help improve the efficiency and quality of service.

Customer initiatives – Supporting this customer experience programme, the business has increased staff training, better aligned staff incentive mechanisms, put new service level arrangements in place, substantially reduced work queues and backlogs, and proactively contacts customers to keep them informed of progress in respect of their enquiries. This is delivering an improved customer experience and reduces unnecessary and repeat calls, thereby improving efficiency. Although UUW has made good progress in the area of customer service, the business recognises that it needs to reduce further the number of customer complaints and an encouraging performance in 2010/11 saw UUW achieve an 85 per cent reduction in customer complaints assessed by the Consumer Council for Water (CCW), compared with the previous year. Nonetheless, customer service remains a significant area of continued management focus.

Safe, clean drinking water – UUW has an action plan to ensure safe, clean drinking water through maintaining and improving the robustness of its water treatment processes, refurbishing service reservoir assets, ongoing mains cleaning and optimising water treatment to reduce discoloured water events. UUW continues to supply a high quality of drinking water, with a mean zonal compliance water quality performance of 99.96 per cent, which compares with 99.94 per cent the previous year, and is focused on maintaining these high levels.

Water supply and demand balance – To help ensure a continuous water supply to its customers, UUW's action plan includes innovation and investment in remote monitoring to better manage and control the company's water supply system. UUW also has investment projects to optimise water pressures and improve network resilience. In addition, the company is improving its response to burst mains to help keep the water flowing, supported by 'wet' repairs to water mains where the supply remains on through the repair process. The company is now close to opening the West East Link, a significant capital project designed to improve further the water supply and demand balance in its region and enhance network resilience to climate change.

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

Business review (continued)

Business objectives and performance (continued)

Key performance indicators:

- **Serviceability** – Long-term stewardship of assets is critical and UUW improved its position in the area of wastewater non-infrastructure in Ofwat's 2009/10 serviceability assessment (Ofwat defines serviceability as the capability of a system of assets to deliver a reference level of service to customers and to the environment now and in the future). All four asset classes (water infrastructure, water non-infrastructure, wastewater infrastructure and wastewater non-infrastructure) are now rated 'stable' and the business expects to retain this position for 2010/11. The aim is to retain a 'stable' rating for all four asset classes, which is aligned with Ofwat's target.

- **Service incentive mechanism (SIM)** – Although Ofwat has only just introduced this new measure, which has replaced the overall performance assessment (OPA) measure, UUW's indicative assessment suggests that the company is in the fourth quartile. The aim is to move to the first quartile in the medium term.

Lowest sustainable cost

Actions:

Staff and pensions – The group reduced staffing levels in 2009/10 and placed its pension provision on a more sustainable footing. These measures are helping UUW in meeting its regulatory efficiency targets.

Asset optimisation – The company's asset optimisation programme is progressing well, providing the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power (CHP) assets to improve energy efficiency. The company's wastewater treatment optimisation programme is targeting approximately £9 million of annual savings by 2013.

Proactive approach – The business is introducing a more proactive approach to asset and network management, with the aim of improving its modelling and forecasting to enable it to address more asset and network problems before they occur, thereby reducing the level of reactive work and improving efficiency.

Power hedging – UUW has increased its power hedging and has now substantially locked in its power requirements through to 2014/15, securing outperformance. Power unit costs for 2010/11 are approximately 20 per cent lower compared with 2009/10 and the business expects to benefit from this reduced cost level through 2011/12. Although power rates beyond 2011/12 have been secured at higher levels than those for 2011/12, this still delivers additional outperformance versus the regulatory contract.

Debt collection – The business is adopting a more proactive approach to debt collection. It has a detailed action plan in place, which includes enhancing systems to improve customer segmentation analysis and to obtain better data on customers who have moved address, coupled with a more proactive debt follow up strategy. To support this, a proportion of its debt collection function which was previously off-shored has now been brought back in-house. In addition, the company is planning to use more local authority collection agreements. The bad debt performance for 2010/11 has been encouraging.

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

Business review (continued)

Business objectives and performance (continued)

Leakage management – The performance of the business in meeting its regulatory leakage target for 2010/11 was exemplary, given the extreme winter weather. Winter temperatures were well below the long-term average and fell as low as minus 15 degrees Celsius on several occasions. It was the coldest December in the UK for over 100 years. The freeze and subsequent thaw resulted in a significant increase in leakage levels. Strong management focus and outstanding commitment from employees enabled the business to meet its 2010/11 regulatory leakage target of 464 megalitres per day and, importantly, with minimum customer disruption.

Capital delivery – The business has utilised previous experience to improve the terms and conditions of its supplier contracts and has a robust commercial capital delivery framework in place for the 2010–15 period. Contractor performance is aligned with the company's business plan through appropriate incentive arrangements. Good progress in the delivery of outputs has been achieved in the first year of the new regulatory period, reflecting a smoother and more efficient investment profile than that experienced in the 2005–10 period.

Sludge processing – A new £100 million sludge processing centre is being developed at the company's Davyhulme wastewater treatment works in Manchester. Sludge will arrive from seven feeder treatment works and will be processed using advanced thermal hydrolysis technology. The new facility will provide a range of benefits including energy self-sufficiency for the whole site, greater sludge disposal flexibility, with a wider choice of land disposal due to the advanced stage of the treated product, and improved sludge condition to enhance the efficiency of incineration. There will also be the option to pump the treated sludge to UUW's Shell Green sludge processing centre in Widnes. The project is scheduled to be completed in early 2013.

Key performance indicators:

- **Relative efficiency –** UUW has sustained its relative efficiency bandings as assessed by Ofwat for a number of years, at band B for the water service and band C for the wastewater service. This places UUW in the third quartile and the business aims to move to the first quartile in the medium-term.

- **Leakage –** UUW met its economic level of leakage rolling target for the fifth consecutive year in 2010/11, despite extreme winter weather conditions, reflecting strong management focus and the outstanding commitment of the workforce. The aim is to meet its regulatory leakage target, as set by Ofwat, each year.

Responsible manner

Actions:

Corporate responsibility – Sustainability is fundamental to the manner in which the group undertakes its business and the group has for many years included corporate responsibility (CR) factors as a strategic consideration in its decision making. One example of the group's actions is its partnership with environmental regeneration charity, Groundwork, where every £1 invested by the company leverages £3, which helps fund community schemes in socially and economically deprived areas where the group is carrying out capital works. This has contributed to United Utilities achieving the highest platinum plus ranking in Business in the Community's (BITC) CR index and being recognised as BITC's Company of the Year for 2010, as well as being rated 'World Class' in the Dow Jones Sustainability Index. The group CR policy sets out its commitment to environmental, social and economic improvements and this is communicated in a way that enables all employees to recognise how their roles and responsibilities contribute to maintaining and improving sustainability performance.

Business review (continued)

Business objectives and performance (continued)

Sustainable catchment management programme – The group owns approximately 57,000 hectares of land in the North West which it holds to protect the quality of water entering its reservoirs. The group has developed a sustainable catchment management programme which will help to enhance biodiversity and protect and improve water quality.

Renewable energy – The company has a detailed carbon and renewable energy plan, which contributes both to sustainability and reduces costs. In 2010/11 UUW generated 111 GWh of renewable electricity, principally from sludge processing. This represents approximately 14 per cent of the group's total electricity consumption.

Environmental performance – This is a high priority for the company and UUW has more than halved the number of major pollution incidents over the last few years. Wastewater treatment works compliance remains high at 97.8 per cent, a similar performance to the previous year. UUW is working more closely with the Environment Agency (EA), through its agreed protocol, to help minimise the occurrence and environmental impact of pollution incidents. This includes the sharing of resources, knowledge and expertise. The company is also enhancing its telemetry and flow monitoring equipment to provide early identification of incidents to enable prompt action to be taken to minimise the potential impact. Recognising that environmental performance is wide-ranging, the company will be measuring itself against an EA composite measure as detailed in the key performance indicators below.

Key performance indicators:

- **Environmental performance** – The EA computes a composite measure which incorporates a broad range of areas including pollution. UUW was ranked tenth out of ten water and sewerage companies for 2008/09, but improved to sixth position for 2009/10 (EA's latest assessment) and has reduced the number of major pollution incidents this year, which will contribute to the assessment for 2010/11. The company aims to move from this average relative position to the first quartile in the medium term.

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

Outperformance of regulatory contract

Financing outperformance – The group has secured £300 million of financing outperformance over the 2010–15 period, based upon an RPI inflation rate of 2.5 per cent per annum. A one per cent per annum increase in RPI above this level would increase financing outperformance by more than £100 million across the five-year period. The aim is to raise future financing, as required, at interest rates that will deliver further outperformance when compared with Ofwat's allowed cost of debt of 3.6 per cent real. UUW has recently agreed a new £200 million index-linked loan with the European Investment Bank at an average real interest rate of 1.2 per cent, which secures additional financing outperformance of around £20 million through to 2015.

Operating expenditure outperformance – The business is targeting total operating expenditure outperformance over the 2010–15 period of at least £50 million, or approximately two per cent, compared with the regulatory allowance. This is in addition to the base operating expenditure efficiency targets set by Ofwat, which equate to a total of approximately £150 million over the five years. UUW has made good progress in 2010/11 and has achieved operating expenditure outperformance of around £10 million.

Capital expenditure outperformance – UUW is delivering significant efficiencies in the area of capital expenditure and, although it is striving for outperformance, expects broadly to meet Ofwat's revised allowance after adjusting, through the regulatory methodology, for the impact of lower construction output prices.

Business review (continued)

Business objectives and performance (continued)

Political and regulatory developments

UUW is actively involved in political and regulatory developments that relate to the UK water sector and has a proactive programme to regularly engage with the key parties.

Private sewers – The UK Government has now tabled before parliament regulations to transfer the ownership of and responsibility for private sewers to the English and Welsh water and sewerage companies from 1 October 2011. This is a significant asset base and UUW expects the length of its sewer network to increase by around 80 per cent. This should provide long-term benefits for both customers and the industry, although it will inevitably result in additional cost and operational workload and an increase in customer contacts. However, the company has been preparing for this for some time and mobilisation activities are underway to help ensure a smooth transfer.

Although the assets are expected to be transferred at zero value, future capital expenditure should provide the opportunity for further growth in the regulatory capital value (RCV). Whilst final details of the transfer are still to be determined, UUW currently estimates that it will incur additional operating expenditure totalling around £55 million over the remainder of the 2010–15 period. Capital expenditure is estimated to be approximately £125 million across the same period, of which around £90 million is expected to be infrastructure renewals expenditure (IRE) and the balance enhancement expenditure.

For private sewers expenditure in 2011–15, under Ofwat's regulatory framework, the group expects, as a minimum, that shareholders will receive appropriate returns on the enhancement capital expenditure (subject to Ofwat's assessment of efficiency) and IRE (subject to Ofwat's application of the capital expenditure incentive scheme). In addition, the company will review regularly whether an enhanced outcome for shareholders can be achieved through the submission of a request for an Interim Determination of K. For expenditure beyond 2015, the group expects shareholders to receive appropriate returns on all private sewers expenditure provided that the money is spent efficiently.

The same regulations will provide for the transfer of private pumping stations. There are estimated to be several thousand of these in the UUW's region. As they require to be surveyed and may need remedial work for health and safety and performance reasons, the transfer date for pumping stations is expected to be by 1 October 2016. UUW expects to incur capital expenditure of approximately £10 million by 2015 in respect of the adoption of private pumping stations, with the majority expected to be adopted in the first year of the subsequent regulatory period. This estimated spend is included within the aforementioned £125 million total capital expenditure spend over the remainder of the 2010–15 period.

Regulatory reviews – It has been a busy year for water issues in the political and regulatory arenas. Against a backdrop of Defra's review of Ofwat, Ofwat's own reviews and consultation on price limits, as well as planned White Papers on the Natural Environment and on Water, UUW has been closely engaged in developments with the aim of helping to shape the outcomes for the benefits of customers, shareholders and other stakeholders.

The business sought to focus the debate onto areas such as how the sector can help address climate change and sustainability issues by reforming water abstraction and water trading arrangements. The company has emphasised to politicians and regulators that the sector has a busy change agenda with the transfer of private sewers and that benchmark competition has already delivered significant environmental and customer service benefits. The company is encouraged that its calls for less regulation are being considered and is seeking incentives to encourage the industry to innovate more. The UK Government's planned Water White Paper, which is now scheduled to be published in autumn 2011, is expected to cover these issues.

Business review (continued)

Business objectives and performance (continued)

Capital structure

Capital risk management

This has been detailed on page 70 in note 20 of the financial statements.

Liquidity and capital resources overview

Short-term liquidity requirements are met from the company's normal operating cash flow and its committed credit facilities. This liquidity supports the company's €2 billion euro-commercial paper programme.

In line with the board's treasury policy, the company aims to maintain a healthy headroom position. Available headroom at 31 March 2011 was £291 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover the company's projected financing needs through to spring 2012.

UUW 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. The company's cash is held in the form of short-term (generally no longer than three months) money market deposits with either prime commercial banks or with triple A rated money market funds. As at 31 March 2011, no cash deposits were held in money market funds.

UUW 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.

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

Debt financing and interest rate management

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

Very long-term sterling inflation index-linked debt is the company's preferred form of funding as this provides a natural hedge to assets and earnings. At 31 March 2011, approximately 43 per cent of the company's net debt was in index-linked form, representing around 27 per cent of the company's regulatory capital value, with an average real interest rate of 1.8 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets, and is a key contributor to the company's average term debt maturity profile, which is in excess of 25 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, to manage exposure to long-term interest rates, the debt is generally swapped to create a floating rate sterling liability for the term of the liability. To manage exposure to medium-term interest rates, the company fixed interest costs for a substantial proportion of the company's debt for the duration of the current five-year regulatory period around the time of the price review. UUW does not undertake any speculative trading activity.

Basis of preparation

The financial statements for the year ended 31 March 2011 have been prepared under the historical cost convention and in accordance with applicable UK accounting standards and, except for the treatment of certain grants and contributions (see note 1), with the Companies Act 2006.

Business review (continued)

Critical accounting policies

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

Carrying value of long-lived assets

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

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

Renewals accounting

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

Revenue recognition

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

The company 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 amount billed is dependent upon 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 company recognises revenue for unbilled amounts based on estimated usage from the last billing date through to the end of the financial year.

Business review (continued)

Critical accounting policies (continued)

Revenue recognition (continued)

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

Provision for doubtful debts

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

Accounting for provisions and contingencies

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

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

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

Pensions

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

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

Derivatives and borrowings - hedging

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

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

Business review (continued)

Critical accounting policies (continued)

Derivatives and borrowings – hedging (continued)

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

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

Derivatives and borrowings - valuation

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

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

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

Taxation

The company accounts for deferred tax on a discounted basis, as permitted by UK GAAP. The deferred tax provision under UK GAAP as at 31 March 2011 is £325.7 million (2010: £329.2 million). The balance sheet provision is discounted using the rates of interest at the balance sheet date on UK gilts with similar maturity dates and currencies to those of the deferred tax assets and liabilities. Therefore, the company uses 15+ years UK gilt rate to reflect the long-life nature of infrastructure and operational assets. An increase or decrease in applicable discount rates of 0.1 per cent would change the balance sheet provision at 31 March 2011 by approximately £12.0 million and the tax charge, for the year then ended, by the same amount.

Assessing the outcome of uncertain tax positions requires judgement to be made regarding the result of negotiations with, and enquiries from, HM Revenue and Customs ('HMRC').

Research and development

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

The company is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The company also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the company was £0.9 million in the year ended 31 March 2011 (2010: £0.8 million).

Business review (continued)

Events after the balance sheet date

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2011.

Corporate responsibility

Developing talent

Talent is a main focus area for Corporate Responsibility and further information is available in the Employees section below.

Customer service

Customer service is important to the company. For information on customer activity please see page 11. The company recognises that in the current economic climate some customers may be experiencing financial difficulty and struggling to pay their water bills. The company offers a range of payment options for customers. One of the easiest ways to pay is by Direct Debit and last year nearly 38,000 Direct Debit mandates were set up. The company also runs an arrears allowance scheme which matches, pound for pound, debt repaid by customers who sign up, and keep to, an easy payment scheme.

Community investment

Last year the company invested approximately £2 million in the communities in which it operates, including cash, time and in-kind contributions. It supported employees involved in community activity by linking volunteering activity to personal development. Investment included the United Futures partnership with Groundwork to deliver bespoke community projects that support core business objectives. The company continued its support of WaterAid by promoting the charity to customers and organising staff-led fundraising events.

The company continued to run campaigns designed to educate communities. For example, its ‘What Not to Flush’ campaign shows the damage that can be caused when unsuitable items are flushed away and cooking fat is disposed of inappropriately.

Natural resource protection and environmental enhancement

UUW is committed to protecting and enhancing natural habitats and biodiversity as part of the way it manages operational sites and landholdings. In April 2010, the group celebrated the completion of its first Sustainable Catchment Management Programme (SCaMP). SCaMP won the BitC Northern Foods Rural Action Award and a Gold Green Apple Environment award. The company received Ofwat approval for a number of catchment schemes in the current five-year investment period. These extend the SCaMP approach to its northern and central catchment landholdings.

In 2010, the group secured regulatory funding to extend a biodiversity programme to 16 operational water sites. This project aims to embed proactive management of biodiversity into the management, operation and maintenance of operational sites and make biodiversity considerations everyday practice.

Sustainable consumption and production

Through the operation and maintenance of water and wastewater assets the company generates waste materials such as sludges, excavated materials and general office waste. Last year, over one million tonnes of waste was generated, 89 per cent of which was diverted from landfill by either recycling, finding an alternative use or by incinerating and recovering the energy produced.

Each year the company spends more than £1.4 billion with over 5,000 local, national and international suppliers. This is managed by teams who receive advanced training and coaching in sustainable supply chain techniques. This means the sustainable performance of the supply chain can continually improve.

Business review (continued)

Corporate responsibility (continued)

Climate change and energy

Following extensive review in 2010, the company updated its carbon strategy to take account of internal and external changes. The company is targeting a 21 per cent reduction in carbon emissions by 2015 based on a 2005/06 baseline. Emissions in 2010/11 were 570,963, similar to last year because energy reduction activities were countered by additional energy use driven by the drought and freezing weather conditions. Renewable generation from sludge and other sources increased by five per cent last year to over 111 GWh and the company remains confident it will meet its 2015 target.

UUW is prepared for the Carbon Reduction Commitment Energy Efficiency Scheme, which began in April 2010, and through its reduction strategy is taking action to reduce the cost impact of the scheme. To ensure that carbon accounting is of the highest standard the group attained the Certified Emissions Measurement and Reduction Scheme certification for its carbon accounting methodology. This is verified externally to meet the requirements of ISO 14064:1. The company encourages its suppliers to do the same.

As required under the 2008 Climate Change Act, the company submitted to government, along with the rest of the water sector, its adaptation report. This sets out its approach to risk assessment and the plans it will implement to adapt to predicted climatic changes.

Employees

The company aims to create a great place to work, ensuring the right people with the right skills are in the right roles to deliver the best possible service to its customers.

Health and safety

The reported accident incidence rate per 100,000 employees (injuries causing an absence of greater than one day) increased from 740 to 1,101, reflecting an unfortunate rise in accidents. In response, United Utilities has sought to consolidate its health and safety management framework and renew its focus on ‘back to basics’ for good health and safety practice, linked to improvement plans which are in place across the company.

The company has introduced a new dedicated incident ‘hotline’ and integrated data analysis and reporting solution, launched a safety awareness campaign and developed robust procedures governing accident investigation. The competence of employees plays a key part in minimising the risks they face and reduces the group’s risk exposure. United Utilities continues to develop new ways to measure and review competence in health and safety skills, and increasingly, in security and risk management.

The reported accident incidence rate per 100,000 employees for the company’s contractors is 416, representing a significant improvement over the prior year’s performance of 1,232 (restated).

The importance of preventing occupational ill health can not be overstated. United Utilities provides health monitoring arrangements through its partner Serco in particular, employment, surveillance, absence interventions and lifestyle services as part of our health protection and prevention programme. The company continues to review the services provided to make improvements where required not only to ensure value for money but also to provide the best experience for our employees.

Employee engagement

Importance is placed on strengthening employees’ engagement, measuring annually then acting to improve how they feel about the company, understand its direction and are motivated to go beyond the requirements of the job. United Utilities’ engagement score is 82 per cent, which is tracking at UK high performance levels of engagement. More employees than ever before said they had seen action as a result of the feedback they gave in the previous year’s survey, with 61 per cent recognising that improvements had been achieved, a score significantly above UK high performance norms.

Business review (continued)

Employees (continued)

Workplace environment

There is a strong focus on talent and skills development. Developing a flexible, skilled and efficient workforce is critical to the company's ability to deliver improved services to customers.

Employees are supported through training and further education and line managers have access to a number of accredited programmes through the Institute of Leadership and Management.

Apprenticeships and graduate recruitment are considered an essential part of developing the group for the future – there are currently almost 100 apprentices, spread across the North West in a variety of roles with a further 40 apprentices to be recruited each year for the next three years. United Utilities was recognised by the National Apprenticeship Service for its commitment and support to the training and skills of apprentices. In 2010 United Utilities took on seven engineering graduates and will be recruiting more graduates in 2011.

Policies on maternity, paternity, adoption, personal and special leave go beyond the requisite legal obligations. A large majority of employees are members of the company pension schemes, which includes two defined benefit (closed to new members) and a defined contribution scheme.

UUW works with its trade unions under an employee relations framework to ensure positive relationships. The group is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. Equal consideration is given to applicants with disabilities in the employment criteria and the group will modify equipment and working practices wherever it is safe and practical to do so.

The company's business principles make clear how it and all 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 though a confidential telephone line.

Principal risks and uncertainties

The group maintains an internal control framework that assesses, throughout the year, the nature and magnitude of internal and external risks to the achievement of business goals (see also the corporate governance section of this report). Managers are required to employ both proactive and reactive mitigation measures in a prioritised manner to reduce exposures and ensure ongoing resilience should a risk materialise. The executive management team regularly reviews significant risks so that the board can determine the nature and extent of those risks it is willing to take in achieving its strategic objectives. The audit committee regularly reviews the framework's effectiveness and the group's compliance with it. The principal risks and uncertainties are summarised here.

Government market reform agenda

Risk

The government is introducing a White Paper later this year which may implement some or all of the recommendations contained in the 2009 Cave report which include:

- extending competition to all non-domestic customers and splitting off the company's retail operations to facilitate the same;
- facilitation of abstraction licence trading to tackle over abstraction;
- reform of the special merger regime to allow mergers of water companies where these would be in the customer's interest; and
- reform to the inset appointment regime with regulated access and supply frameworks.

Business review (continued)

Principal risks and uncertainties (continued)

Government market reform agenda (continued)

Mitigation

The company has been fully engaged in the government and Ofwat consultations on the Cave review and other aspects of competition. A relatively small proportion of the company's profits derive from the retailing of water and wastewater services to non-household customers. However, the company recognises that reforms to the pricing rules that govern access to the company's water network and greater upstream competition could put at risk a greater proportion of the company's profits. Equally, if competition is expanded, there would also be opportunities for the company to participate in a wider market in England and Wales.

Capital investment programmes

Risk

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

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

Mitigation

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

Service incentive mechanism

Risk

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

Mitigation

The company has been monitoring and measuring customer satisfaction for a number of years and results have been improving consistently. To build on this success and in preparation for the change to SIM, a dedicated project team has been set up to ensure our processes, behaviours and systems provide consistent and excellent service to our customers. The company's focus is on ensuring right first time service delivery to its customers, thus avoiding the need for 'unwanted' contacts. Where 'unwanted' contacts do arise, then there is a clear focus on identifying the root causes. These actions are intended to ensure that the company's performance under SIM is optimised thereby mitigating the risk of a penalty at the next price setting.

Business review (continued)

Principal risks and uncertainties (continued)

Serviceability assessment

Risk

The company is required to maintain the serviceability of its water and wastewater assets, ensuring they continue to deliver a level of service and performance at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat would deploy a staged approach to regulatory action to secure corrective action by UUW and could make financial adjustments at the next price setting. Or, if performance was to decline, the company may incur additional operating or capital expenditure to restore performance.

Mitigation

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

The adoption of private sewers

Risk

In 2008, the government announced its intention to transfer sewers and pumping stations currently owned by private individuals and businesses to sewerage undertakers. The transfer is expected on 1 October 2011 for private sewers and by October 2016 for pumping stations. No allowance has been made in price limits for the costs associated with the transfer. Therefore, any costs incurred will represent an unbudgeted increase in operating and capital expenditure compared with the Ofwat allowance in the 2010–15 price determination.

Mitigation

UUW will seek to mitigate the impact of the costs associated with the transfer when price limits are next reset, either at an interim determination or the next periodic review.

Pension scheme obligations

Risk

The company participates in a number of pension arrangements. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of company finances, with the funds being well diversified and professionally managed. The company's current schemes had a combined FRS 17 'Retirement benefits' net deficit of £105.7 million as at 31 March 2011, compared with a net deficit of £136.6 million as at 31 March 2010.

Mitigation

Increases to pension fund deficits may result in an increased liability for the company, the size of the liability depending upon the extent to which additional deficits are recoverable through the regulatory price determination process. In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit payable over a ten year recovery period shown in UUW's final business plan when setting its overall price controls. In response to the size of its ongoing pension risks and pension costs the company has recently been consulting on a series of changes for employees in its defined benefit schemes. These changes, which came into force on 31 March 2010, will result in reduced costs and risks, including deficit, associated with defined benefit liabilities in future. In conjunction with the trustees, the company continues to monitor the investment strategy for the pension schemes, including the company's exposure to investment risks.

Business review (continued)

Principal risks and uncertainties (continued)

Failure to comply with applicable law or regulations

Risk

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

Mitigation

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

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

Risk

The company controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service. In exceptional circumstances, a significant interruption of service provision such as prolonged drought or catastrophic damage, such as a dam burst could occur resulting in: significant loss of life; and/or environmental damage; and/or economic and social disruption. Such circumstances might arise, for example, from water shortages; the failure of an asset or an element of a network or supporting plant and equipment; human error; an individual’s malicious intervention; or unavoidable resource shortfalls. The group could be fined for breaches of statutory obligations or held liable to third parties, or be required to provide an alternative water supply of equivalent quality, which could increase costs. The company is also dependent upon the ability to access, utilise and communicate remotely via electronic software applications mounted upon corporate information technology hardware and communicating through internal and external networks. The ownership, maintenance and recovery of such applications, hardware and networks are not wholly under its control.

Business review (continued)

Principal risks and uncertainties (continued)

Mitigation

The company operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, alongside related risk management and business continuity procedures which complement the governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works. These recognise that possible events can have varying causes, impacts and likelihoods. Sustainability of our water supply is also managed through regional aqueduct networks which will be enhanced by the completion of the West East Link pipeline. While the group seeks to ensure that it has appropriate processes and preventative controls in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of customers, regulators, government and the wider stakeholder community. The company also maintains insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost effectively. The licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat in the event of a catastrophic incident.

Material litigation

Risk

In March 2010, Manchester Ship Canal Company (MSCC), owners of the Manchester Ship Canal (the 'canal'), issued proceedings, seeking, amongst other relief, damages alleging trespass against UUW in respect of UUW's discharges of water and treated effluent into the canal. The respective legal rights of MSCC and UUW relating to the discharges are unclear. Accordingly, the relevant legal principles need to be tested through court process. UUW have filed a defence and counterclaim in support of its believed entitlement to make discharges into the canal without charge and MSCC's claim will be vigorously defended thereafter. We now await MSCC's response to our defence and counterclaim.

The company faces the general risk of litigation in connection with its business. In most cases, liability for litigation is difficult to assess or quantify; recovery may be sought for very large and/or indeterminate amounts and the existence and magnitude of liability may remain unknown for substantial periods of time.

Mitigation

The company robustly defends litigation where appropriate and seeks to minimise its exposure to such claims by early identification of risks and compliance with its legal and other obligations. Based upon the facts and matters currently known and the provisions carried in the company's balance sheet, the directors are of the opinion that the possibility of the dispute referred to in this risk section having a material adverse effect on the company's financial position is remote.

Business review (continued)

Cautionary statement regarding forward looking statements

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

The company cautions investors that a number of important factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statements. These factors include:

(i) the effect of, and changes in, regulation and government policy;

(ii) the effects of competition and price pressures;

(iii) the ability of the company to achieve cost savings and operational synergies;

(iv) the ability of the company to service its future operations and capital requirements;

(v) the timely development and acceptance of new products and services by the company;

(vi) the effect of technological changes; and

(vii) the company's success in managing the risks of the foregoing. The company cautions that the foregoing list of important factors does not address all the factors that could cause results to differ materially.

Directors' report

The directors present their report and the audited financial statements of the company for the year ended 31 March 2011.

Profit and dividends

The results for the year, set out in the profit and loss account on page 39, show that turnover for the year ended 31 March 2011 was £1,485.5 million, a decrease of 4.1 per cent over the previous year. Profit for the year before tax was £333.8 million (2010: £438.7 million).

Dividends are only recognised in the financial statements if they are declared and approved in that financial year. Dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date. An interim ordinary dividend of £262.2 million has been declared and paid during the year (2010: interim dividend of £231.2 million declared and paid during 2010).

The directors have not recommended a final ordinary dividend for 2010/11 (2010: £nil).

Regulation

As required by paragraph 3.1 of Condition K of the Instrument of Appointment granted by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Industry Act 1991 ('the Licence'), the directors state that they are satisfied that as at 31 March 2011, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of United Utilities Water PLC, the company would have had available to it sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company so that the purpose of the order could have been achieved.

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

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

Business review and principal activities

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

The chairman's and chief executive officer's statement and the business review on pages 5 to 27 report on the company's activities during the year and on likely future developments. A summary of KPIs can be found in the business review.

The directors of United Utilities Water PLC advise that all the information supplied in the chairman's and chief executive officer's statement beginning on page 5 and the business review on pages 8 to 27 is part of the directors' report as incorporated by reference. Any liability for the information is restricted to the extent prescribed in the Companies Act 2006.

Principal risks

The principal risks and uncertainties are commented on within the business review beginning on page 8.

Directors’ report (continued)

Research and development

Details are commented on within the business review beginning on page 8.

Employment policies

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

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

Proper attention to health and safety is an indispensable part of the company’s commitment to high standards in every aspect of the business. Further details are commented on within the business review beginning on page 8.

Supplier payment policy and practice

Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance. As at 31 March 2011, the average credit period taken for trade purchases was 37 days (2010 restated: 33 days).

Financial instruments

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

Directors

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

Non-executive directors	
CED Bell (1)	(appointed 31 March 2011)
R Bird	(resigned 30 March 2011)
P Heiden (1)	(appointed 31 March 2011)
DH Jones (1)	(appointed 31 March 2011)
JDG McAdam (1)	(appointed 31 March 2011)
DE Morton	(resigned 30 March 2011)
PW Jowitt	(resigned 30 March 2011)
NR Salmon (1)	(appointed 31 March 2011)
Executive directors	
M Carmedy (2)	(resigned 30 March 2011)
S Fraser	(resigned 30 March 2011)
PN Green (3)	(resigned 30 March 2011)
JR Houlden (4)	(appointed 1 October 2010)
SL Mogford (5)	(appointed 30 March 2011)
GL Sims	(resigned 30 March 2011)
TP Weller (6)	(resigned 21 May 2010)
MR Wright	(resigned 25 February 2011)
Company secretary	
TS Keevil	(resigned 31 March 2011)
SR Gardiner	(appointed 31 March 2011)

Directors' report (continued)

Directors (continued)

(1) Director, United Utilities Group PLC

(2) Director, United Utilities PLC (appointed 21 May 2010)

(3) Director, United Utilities Group PLC (resigned 31 March 2011) and United Utilities PLC (resigned 31 March 2011)

(4) Director, United Utilities Group PLC (appointed 1 October 2010) and United Utilities PLC (appointed 1 October 2010)

(5) Director, United Utilities Group PLC (appointed 1 January 2011) and United Utilities PLC (appointed 4 April 2011)

(6) Director, United Utilities Group PLC (resigned 21 May 2010) and United Utilities PLC (resigned 21 May 2010)

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

Directors' indemnities and insurance

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

Disclosure of information to the auditor

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

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

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

Auditor

The board is proposing that shareholders reappoint KPMG Audit Plc as auditor at the forthcoming annual general meeting.

Approved by the board and signed on its behalf

JR Houlden

Director

30 June 2011

Corporate governance report

The Combined Code

In August 2008 United Utilities Water PLC ('UUW', the 'company' as the context requires) agreed with its regulator, Ofwat, a Licence amendment that the company should 'have regard to' the Combined Code on Corporate Governance ('the Code') which was published by the Financial Reporting Council in June 2008. In 2010, with the completion of the disposal of all the group's material non-regulated interests, the group obtained agreement from Ofwat to a new structure that allowed for directors to be members of the boards of both the company and its ultimate holding company United Utilities Group PLC ('UUG') to increase the efficiency and effectiveness of the corporate governance structure. These changes took place at the end of March 2011.

As a general rule, the board was minded to have regard to the provisions of Section A of the Code ('Directors') in full, subject only to a number of departures which reflect that UUW is a wholly owned subsidiary of a listed company, which itself complies fully with the Code. Any departures from the Code within Section A are fully explained below.

The board also considered the Code provisions of Section B ('Remuneration'), Section C ('Accountability and Audit') and Section D ('Relations with Shareholders'). After due consideration, it was concluded that none of these sections were appropriate for UUW.

The reasons for the non-application set out on page 35 of Sections B, C and D as have been notified to Ofwat. This report gives details of how those principles of Section A of the Code have been applied during the year.

The board of directors

The directors who served during the year are set out on page 30. Ten board meetings are scheduled each year and the board will meet more or less frequently as required. During the year nine meetings were held (2010: ten).

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

Board

R Bird	8	(9)
M Carmedy	7	(9)
S Fraser	9	(9)
PN Green	8	(9)
JR Houlden	4	(4)
PW Jowitt	8	(9)
DE Morton	9	(9)
GL Sims	7	(9)
TP Weller	2	(2)
MR Wright	9	(9)

Notes:

(1) Tim Weller resigned from the board on 21 May 2010.
(2) Russ Houlden was appointed to the board on 1 October 2010.
(3) Matthew Wright resigned from the board on 25 February 2011.
(4) Philip Green, Richard Bird, Mick Carmedy, Steve Fraser, Professor Paul Jowitt, Deborah Morton and Graeme Sims resigned from the board on 30 March 2011. Tom Keevil also stepped down as company secretary and was replaced by Simon Gardiner on the same date. Steve Mogford was appointed to the board on 30 March 2011.
(5) The current UUG directors (Dr John McAdam (chairman of UUG) and the independent non-executive directors of UUG; Dr Catherine Bell, Paul Heiden, David Jones and Nick Salmon) were appointed to the UUW board on 31 March 2011. On appointment, Dr John McAdam assumed the role of chairman of UUW.

Corporate governance report (continued)

Summary of approach to governance

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

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

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

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

Principal committees of the board (summary)

The board has formally delegated specific responsibilities to certain committees, including the following: approvals; regulation and treasury. All board committees are provided with sufficient resources to undertake their duties, have authority to seek independent advice, if appropriate, and are supported by the company's secretariat. The board has delegated certain of its powers and functions to the following committees:

Approvals committee This considers and approves expenditure and investment proposals within limits determined by the board and the internal control manual.

Regulation committee Within limits determined by the board, this had responsibility for the approval of regulatory policies and strategies and for overseeing interactions with the company's regulators. All directors who served during the year were members of the regulation committee.

Treasury committee This considers and approves borrowing, leasing, bond and other banking facilities within limits set by the board. Its members are the executive directors.

On 31 March 2011, to reflect the transition to common board directors between UUW and UUG, the board delegated powers for capital expenditure (within specified limits) to members of the senior management team. The regulation committee was disbanded with its powers being delegated to the director of regulation, and certain transactional powers of the treasury committee were delegated to the chief financial officer and treasurer.

Corporate governance report (continued)

Chairman and chief executive director

From 27 May 2009 the positions of chairman and managing director were exercised by Philip Green. On 31 March 2011, Philip Green stepped down as chief executive officer of UUG and as a director of the company, his successor, Steve Mogford, was appointed to the UUW board and assumed the position of its chief executive officer on 30 March 2011. In addition, Russ Houlden assumed the position of chief financial officer of UUW at the same date, and Dr John McAdam was appointed as non-executive chairman of the company on 31 March 2011.

Dr John McAdam and Steve Mogford in their respective roles as chairman and chief executive officer of UUG have terms of reference setting out their roles and responsibilities, which includes those related to the Company. Accordingly, no additional division of responsibilities and terms of reference for the chairman and chief executive officer of UUW are considered necessary.

Board balance and independence

During the year, there were three non-executive directors serving on the board (which complied with the Company's Licence obligation) determined by the board to be independent in accordance with the code. The directors had a wide and diverse range of business and other experience and expertise. The board determined that Mrs DE Morton (resigned 30 March 2011) was independent, notwithstanding that she had served on the board for more than nine years, due to the extent of her experience, financial independence and other professional areas of interest. Going forward, four independent non-executive directors will serve on the UUW board (in addition to the non-executive chairman and the two executive directors). As stated previously, these directors are also directors of UUG. As agreed with Ofwat, the non-executive directors will not be appointed to the board of any other group company.

Senior independent director

Given the company's status as a subsidiary of UUG, the board had previously concluded that it was not appropriate to appoint a senior independent director; any concerns would be raised through the board or any of three independent non-executive directors. Moving forward, given the common board membership, the senior independent director of UUG (currently Nick Salmon) will provide a channel through which any concerns should be raised.

Conflicts of interest

Since 1 October 2008, directors have been under a statutory duty to avoid any situation in which they have, or can have, a direct or indirect interest which conflicts or possibly may conflict with the interests of the Company. The duty is not infringed where a conflict situation has been authorised in advance by the unconflicted directors or the shareholders of the company or where the situation cannot reasonably be regarded as likely to give rise to a conflict of interest. For a public company, the unconflicted directors can only authorise conflict situations if permitted to do so by the company's articles of association.

The companies articles of association contain provisions which permit the unconflicted directors to authorise conflict situations and procedures have been put in place for the disclosure of any conflicts by the directors to the board and for the consideration and, if appropriate, authorisation of such conflicts. The procedures permit any authorisation to be subject to any terms and/or conditions that the unconflicted directors think fit.

Prior to 1 October 2008, each board member completed a comprehensive questionnaire to establish if any director had a conflict of interest under the Companies Act 2006. The results were then assessed by the chairman and the board, who concluded that no director had a conflict that required authorisation. In October 2010, as part of the annual review process, a review of directors' conflicts was undertaken by the company secretary. The results were assessed by the chairman and the board which concluded that no director had a conflict which required authorisation. Any potential issue of conflict relating to prospective directors is addressed by the chairman and the board prior to the appointment being made.

As previously stated, since 31 March 2011, the boards of both UUW and UUG have had common directors. The directors are at all times fully mindful of the fact that they hold a directorship in both companies.

Corporate governance report (continued)

Conflicts of interest (continued)

Moving forward, since UUG disposed of the majority of its non-regulated activities, the potential for situations where potential conflicts of interest could arise has significantly diminished. UUG and UUW will operate as distinct legal entities. Each board has separate matters reserved to it for decision and both boards are assisted through the management of separate agendas, meetings and minutes by the company secretariat and advised in their meetings by the company secretary where appropriate.

Re-appointment of directors

Non-executive directors are appointed for specified terms subject to re-appointment under the company's articles of association and to Companies Act provisions relating to the removal of directors. Any term beyond six years for a non-executive director will be subject to particularly rigorous review, and will take into account the need for progressive refreshing of the board. Any non-executive director serving for longer than nine years will be subject to annual re-appointment, as was the case for Mrs DE Morton. Moving forward, in accordance with the non-executive directors' letters of appointment, should a director not be re-appointed at an annual general meeting of the company's parent (UUG), then he or she must also resign from the UUW board within a prescribed time period.

Information, support and advice

The chairman is responsible for ensuring that directors receive comprehensive information on a regular basis to enable them to perform their duties properly, supported by the company secretary. As part of the preparation process for board meetings, the chairman undertakes informal briefings with the non-executive directors before the scheduled board meetings.

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

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

Induction and training

New directors receive appropriate induction on joining the board, typically including meeting with members of the senior management team and visits to operational sites. During the year, Prof. Paul Jowitt's induction continued. Directors are provided with details of seminars and training courses relevant to their role and are encouraged to attend those that meet their development needs. Additionally, training was provided to the whole board on topics such as the newly implemented Bribery Act, Competition Law and the UK Corporate Governance Code published by the Financial Reporting Council in June 2010. Since their appointment on 31 March 2011, the non-executive directors have received extensive training to understand the company's June Return process and obligations.

Performance evaluation

During the year the board did not conduct an evaluation of its own performance (and that of its committees). The reason for this was due to the alignment of the UUW board with that of its parent UUG in terms of board members. The UUW board therefore concluded that conducting a board performance evaluation would be of very limited value owing to the impending changes that were about to occur. The UUG board undertook its own performance evaluation and will ensure that the recommendations that arose out of the evaluation process are implemented moving forward and that these recommendations will apply to both boards.

Corporate governance report (continued)

Going concern

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This approach, taking into account the relatively stable and regulated nature of the business, is based, amongst other matters, upon a review of the company's budget for 2011/12, the company's proposed five-year business plan and investment programme, together with a review of the cash and committed borrowing facilities available to the company (discussed in further detail in the liquidity and capital resources overview section and the debt financing and interest rate management section on page 16). That review gives details of the company's headroom as at 31 March 2011.

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

Auditor independence

The company adheres to the UUG policies on auditor independence which are described in the UUG accounts (available from the address given in note 30). Non-audit services provided to the company must be pre-approved by the UUG audit committee. Non-audit services received during the year ended 31 March 2011 were primarily relating to regulatory work (see note 3).

During the year, the United Utilities group audit committee took into account the tenure of the group's auditor and considered whether there should be a tender process for the 2011/12 audit. It concluded that such a process was appropriate, which was undertaken in the last quarter of the financial year. Four firms were invited to tender. Following a thorough process, and taking into account that Deloitte had been auditor to the group since 2002, the committee concluded that given the strategic refocus of the group, a change in auditor was appropriate. The audit committee therefore recommended to the board that KPMG Audit Plc be appointed auditor to the group and therefore to the company, following the conclusion of Deloitte's audit of the 2011 financial statements. The appropriate resolution to approve this will be put to shareholders at the forthcoming annual general meeting. There are no contractual obligations restricting the company's choice of external auditor.

Departures from the Combined Code notified to Ofwat

Section B of the Code – Remuneration

The board concluded that having its own remuneration committee was unnecessary and would not improve governance. The company remunerates its directors subject to the confines of UUG's remuneration policy. UUG has its own remuneration committee which, with the help of the human resources director, the reward and pensions director and external consultants as necessary, reviews the pay of directors and the pay scales applicable to senior management. Going forward, in accordance with their letters of appointment the non-executive directors will not receive any remuneration from the company for their services to the UUW board.

Section C of the Code – Accountability and Audit

UUG has an audit committee and the group has a well resourced internal audit function in place (to which the UUW board has access and which reports to the UUW board on a quarterly basis). Accordingly, the board concluded that having a separate audit committee for the company was unnecessary and duplicative.

Section D of the Code – Relations with Shareholders

As a wholly owned subsidiary of UUG, this provision is not relevant to the company. UUG complies fully with this provision and makes a full disclosure on this in its annual report. It should be noted that under Code provision D.1.2, all of UUW's directors, including the non-executive directors, if they so wished, could have access to the annual shareholder opinion survey produced for United Utilities Group PLC by Makinson Cowell.

Statement of directors' responsibilities in respect of the financial statements

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

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

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

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

Independent auditor’s report

to the members of United Utilities Water PLC

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2011 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholders’ Funds, the Balance Sheet, the Cash Flow Statement and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

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

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the company’s affairs as at 31 March 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

Independent auditor's report (continued)

to the members of United Utilities Water PLC

Matters on which we are required to report by exception

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

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

Douglas King (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, United Kingdom
30 June 2011

Profit and loss account

For the year ended 31 March 2011

	Note	2011 £m	2010 £m
Turnover		1,485.5	1,549.2
Net operating expenses (including net exceptional charges of £11.9 million (2010: exceptional credits of £60.9 million))	3	(897.7)	(761.2)
Operating profit		587.8	788.0
Net interest payable and similar charges	7	(254.0)	(349.3)
Profit on ordinary activities before taxation		333.8	438.7
Tax charge on profit on ordinary activities	8	(54.2)	(39.1)
Profit after taxation	23	279.6	399.6

All of the results shown above relate to continuing operations.

Statement of total recognised gains and losses

For the year ended 31 March 2011

	2011 £m	2010 £m
Profit after taxation	279.6	399.6
Actuarial gains/(losses) on defined benefit pension schemes (see note 21)	4.4	(69.4)
Deferred taxation on actuarial (gains)/losses (see note 17)	(1.1)	19.4
Total recognised gains and losses for the year	282.9	349.6

Reconciliation of movements in shareholders' funds

For the year ended 31 March 2011

	2011 £m	2010 £m
Profit after taxation	279.6	399.6
Dividends (see note 9)	(262.2)	(231.2)
Actuarial gains/(losses) on defined benefit pension schemes net of deferred taxation (see notes 17 and 21)	3.3	(50.0)
Net addition to shareholders' funds	20.7	118.4
Opening shareholders' funds	2,215.4	2,097.0
Closing shareholders' funds	2,236.1	2,215.4

Balance sheet

At 31 March 2011

	Note	2011 £m	2010 £m
Fixed assets			
Tangible assets	10	8,051.8	7,854.9
Investments	11	0.2	0.2
		8,052.0	7,855.1
Current assets			
Stock: raw materials and consumables		4.6	3.7
Debtors: amounts falling due within one year	12a	311.8	317.3
Debtors: amounts falling due after more than one year	12b	276.9	270.7
Current asset investments	13	1.6	-
Cash at bank and in hand		0.3	0.3
		595.2	592.0
Creditors: amounts falling due within one year			
Trade and other creditors	14a	(393.2)	(405.6)
Borrowings	14b	(211.0)	(297.3)
		(604.2)	(702.9)
Net current liabilities		(9.0)	(110.9)
Total assets less current liabilities		8,043.0	7,744.2
Creditors: amounts falling due after more than one year			
Trade and other creditors	15a	(170.7)	(174.9)
Borrowings	15b	(5,191.7)	(4,870.5)
		(5,362.4)	(5,045.4)
Provisions for liabilities	17	(338.8)	(346.8)
Net assets excluding pension liability		2,341.8	2,352.0
Pension liability	21	(105.7)	(136.6)
Net assets including pension liability		2,236.1	2,215.4
Capital and reserves			
Called up share capital	22, 23	1,025.3	1,025.3
Share premium account	22, 23	647.8	647.8
Profit and loss account	23	563.0	542.3
Shareholders' funds		2,236.1	2,215.4

The financial statements of United Utilities Water PLC, registered number 2366678, were approved by the board of directors on 30 June 2011 and signed on its behalf by:

JR Houlden
Director

Cash flow statement

At 31 March 2011

	2011 £m	2010 £m
Net cash inflow from operating activities (see note 25)	942.7	1,070.5
Returns on investments and servicing of finance		
Interest received	0.2	8.0
Interest paid	(162.1)	(193.9)
Non-equity dividends paid	(13.6)	(4.6)
Net cash outflow from returns on investments and servicing of finance	(175.5)	(190.5)
Taxation	(68.8)	(103.0)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(606.0)	(657.0)
Grants and contributions received	22.4	16.5
Proceeds from sale of tangible fixed assets	10.0	4.0
Net cash outflow for capital expenditure and financial investment	(573.6)	(636.5)
Equity dividend paid (see note 9)	(262.2)	(231.2)
Cash outflow before management of liquid resources and financing	(137.4)	(90.7)
Management of liquid resources		
(Increase)/decrease in short-term deposits	(1.6)	80.0
Financing (see note 27)	136.7	16.0
(Decrease)/increase in cash and overdraft in the year	(2.3)	5.3

Notes to the financial statements

At 31 March 2011

1. Accounting policies

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

Basis of preparation of financial statements

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

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

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

Actual results could differ from these estimates.

Going concern

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

Exemption from preparing group financial statements

The financial statements contain information about United Utilities Water PLC as an individual company and do not contain consolidated financial information as a parent of a group. Group accounts have not been prepared as the company has no material subsidiaries. The company is included by full consolidation in the financial statements of its ultimate parent United Utilities Group PLC, a company incorporated in Great Britain and registered in England and Wales.

Related party transactions

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

During the year, no transactions were entered into with related parties other than with other group companies in the normal course of business.

Turnover

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

Research and development

Expenditure on research and development is expensed as incurred.

Tangible fixed assets

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

Notes to the financial statements (continued)

At 31 March 2011

1. Accounting policies (continued)

Tangible fixed assets (continued)

Infrastructure assets
Infrastructure assets comprise a network of water and wastewater systems. Expenditure on the infrastructure assets relating to increases in capacity or enhancements of the network are treated as additions, as are asset replacements to maintain the operating capability of the network in accordance with defined standards of service. Repairs to infrastructure assets are treated as operating expenditure.

Additions are included at cost after deducting related grants and contributions. The depreciation charge for infrastructure assets ("Infrastructure Renewals Charge") is the estimated level of annual expenditure required to maintain the operating capability of the network, less the estimated level of relevant annual grants and contributions, which is based on the company's independently certified AMP covering a five year period.

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

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

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

Grants and contributions

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Accounting Regulations') under which the infrastructure assets should be stated at their purchase price or production cost and the capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

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

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

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

Leased assets

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

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

Notes to the financial statements (continued)

At 31 March 2011

1. Accounting policies (continued)

Fixed asset investments

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

Stocks

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

Current asset investments

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

Pensions

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

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

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

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

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

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

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

Notes to the financial statements (continued)

At 31 March 2011

1. Accounting policies (continued)

Financial instruments

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

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

Financial investments
Investments (other than short-term deposits) are initially measured at fair value, including transaction costs. Investments are classified as available-for-sale and are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

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

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

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

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

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

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

Notes to the financial statements (continued)

At 31 March 2011

1. Accounting policies (continued)

Financial instruments (continued)

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 profit and loss account. Designation is made where it can be demonstrated from inception that a highly effective fair value hedge exists. Hedge accounting is discontinued prospectively when the hedging instrument is sold, terminated or exercised, or where the hedge relationship no longer qualifies for hedge accounting.

Borrowings designated at fair value through profit or loss
Where designated, bonds and loans are initially measured at fair value being the cash proceeds received, net of any direct issue costs, 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 profit and loss account. 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.

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

Environmental remediation

Expenditure that relates to an existing condition caused by past operations and does not contribute to current or future earnings is expensed. Liabilities for environmental costs are recognised when there is a legal or constructive obligation, environmental assessments indicate clean-ups are probable and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites.

Taxation

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

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

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

Notes to the financial statements (continued)

At 31 March 2011

1. Accounting policies (continued)

Share-based compensation arrangements

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

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

At each balance sheet date, United Utilities Group PLC revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the options are exercised. United Utilities Water PLC is recharged the amount of expense or income under FRS 20 that relates to the company's employees which is an income of £0.2 million in relation to the year ended 31 March 2011 (2010: expense of £0.9 million).

2. Segmental information

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

Notes to the financial statements (continued)

At 31 March 2011

3. Net operating expenses

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

	2011 £m	2011 £m	2010 £m	2010 £m
Employee costs (including directors)				
Wages and salaries		146.3		136.1
Social security costs		10.6		10.7
Pension costs:				
- pension costs excluding curtailment gains arising on amendment of pension obligations and restructuring costs	13.6		19.5	
- exceptional pension schemes' curtailment gains arising on amendment of pension obligations	-		(76.7)	
- exceptional pension schemes' curtailment losses arising on reorganisation	2.8		-	
		16.4		(57.2)
Exceptional restructuring costs (see below)		2.1		15.8
		175.4		105.4
Less: charged to capital schemes		(62.3)		(67.4)
Charged to profit and loss account		113.1		38.0
Depreciation				
Non-infrastructure depreciation		264.3		229.3
Infrastructure depreciation (see note 10)		141.5		114.4
Total depreciation (see note 10)		405.8		343.7
Other operating expenses				
Exceptional other reorganisation costs (see below)		7.0		-
Hired and contracted services		125.1		120.6
Raw materials and consumables		39.2		41.0
Power		48.3		61.5
Property rates		67.1		52.1
Charge for bad and doubtful debts (see note 12c)		30.2		52.9
Other operating expenses		63.3		56.8
Auditor's remuneration - audit of the company's financial statements		0.2		0.2
Auditor's remuneration - other services (see below)		0.1		0.2
Amortisation of grants and contributions (see note 16)		(6.5)		(6.4)
Research and development		0.9		0.8
Operating leases:				
- plant and machinery		0.7		0.7
- land and buildings		3.1		4.1
Other expense/(income) (see note 4)		0.1		(5.0)
		378.8		379.5
Total net operating expenses		897.7		761.2

Fees payable to Deloitte LLP for non-audit services during the year were £0.1 million, primarily relating to regulatory work (2010: £0.2 million).

Exceptional costs of £11.9 million (2010: exceptional credits of £60.9 million) comprise other reorganisation costs of £7.0 million (2010: £nil), restructuring costs of £2.1 million (2010: £15.8 million) relating to staff severance and pension schemes' curtailment losses arising on reorganisation of £2.8 million (2010: £nil). In the prior year, these were offset by pension schemes curtailment gains arising on amendment of pension obligations of £76.7 million. There were no equivalent credits in the current year.

Notes to the financial statements (continued)

At 31 March 2011

4. Other (expense)/income

	2011 £m	2010 £m
(Loss)/profit on disposal of tangible fixed assets	(1.1)	4.0
Rents receivable	1.0	1.0
	(0.1)	5.0

5. Directors' emoluments

	2011 £m	2010 £m
Aggregate emoluments in respect of qualifying services	3.4	2.2
Aggregate amounts receivable under long-term incentive plans	0.8	-

	2011 Number	2010 Number
Number of directors who received shares in respect of qualifying services	5	6
Number of directors who exercised share options	5	-
Number of directors accruing benefits under defined benefit schemes	-	2

	2011 £m	2010 £m
In respect of the highest paid director		
Aggregate emoluments	1.4	0.6

SL Mogford, JR Houlden, PN Green, TP Weller and M Carmedy were remunerated by United Utilities PLC and a portion of their emoluments is then recharged to United Utilities Water PLC.

There were two directors with incentive plans which vested during the year ended 31 March 2011 (2010: nil).

Details of the employee Sharesave Scheme and the executive share option scheme operated by United Utilities Group PLC are given in that company's financial statements.

All executive directors were either members of the defined contribution section of the company's pension scheme during the year or had opted for a cash allowance in lieu of their defined contribution pension entitlement. The company's defined contribution plan has a normal pension age of 65 and incorporates a salary sacrifice arrangement whereby the employee's contribution to the pension scheme is effected through a salary reduction (see note 21).

6. Employees

	Average 2010/11	Average 2009/10	Total 31 March 2011	Total 31 March 2010
Number of persons employed during the year	4,218	4,257	4,435	4,211

Notes to the financial statements (continued)

At 31 March 2011

7. Net interest payable and similar charges

	2011 £m	2010 £m
Interest payable and similar charges		
On bank loans, overdraft and other loans	252.9	184.9
On borrowings from parent and fellow subsidiary undertakings	3.1	10.0
Interest payable before preference share dividends and fair value adjustments	256.0	194.9
Preference share dividends (see notes 9 and 14b)	9.1	9.1
Total interest payable	265.1	204.0
Fair value (gains)/losses on debt and derivative instruments [(1)]		
Fair value hedge relationships		
- Borrowings	(7.7)	(53.3)
- Designated swaps	2.4	59.9
	(5.3)	6.6
Financial instruments at fair value through the profit and loss		
- Borrowings designated at fair value through the profit and loss [(2)]	(0.8)	8.0
- Held for trading derivatives – economic hedge	1.1	86.0
	0.3	94.0
Held for trading derivatives – 2005-2010 regulatory hedge	(7.3)	(42.6)
Held for trading derivatives – 2010-2015 regulatory hedge	(11.4)	49.7
Net payments on swaps and debt under fair value option	9.3	29.7
Held for trading derivatives – other [(3)]	(3.1)	1.0
Other	2.4	-
Net fair value (gains)/losses [(4)]	(15.1)	138.4
Net pension interest expense (see note 21)	4.2	15.6
Total interest payable and other similar charges	254.2	358.0
Investment income		
Interest receivable and similar income		
- Parent and fellow subsidiary undertakings	-	(7.8)
- External	(0.2)	(0.9)
Total investment income	(0.2)	(8.7)
Net interest payable and similar charges	254.0	349.3

[(1)] Fair value (gains)/losses on debt and derivative instruments includes foreign exchange losses of £3.8 million (2010: £19.0 million gains), excluding those on instruments measured at fair value through profit or loss. These losses/gains are largely offset by fair value gains/losses on derivatives.

[(2)] Includes £4.1 million of losses (2010: £48.2 million losses) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.

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

[(4)] Includes £9.5 million expense (2010: £29.7 million) due to interest on swaps and debt under fair value option.

Notes to the financial statements (continued)

At 31 March 2011

8. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2011 £m	2010 £m
Current tax:		
UK corporation tax at 28% (2010: 28%)	71.6	80.0
Adjustment in respect of prior periods	(26.1)	(15.1)
Tax on exceptional items	(2.6)	(3.8)
Total current tax charge	42.9	61.1
Deferred tax:		
Origination and reversal of timing differences	28.9	28.2
Decrease/(increase) in discount	43.6	(51.9)
Effect of change in rate applied to opening deferred tax balance	(74.5)	-
Adjustment in respect of prior periods	14.1	(19.2)
Tax on exceptional items	(0.8)	20.9
Total deferred tax charge/(credit)	11.3	(22.0)
Total tax charge on profit on ordinary activities	54.2	39.1

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

	2011 £m	2010 £m
Profit on ordinary activities before taxation	333.8	438.7
UK corporation tax at 28% (2010: 28%)	93.5	122.8
Capital allowances in excess of depreciation	(27.7)	(39.4)
Adjustment in respect of prior periods	(26.1)	(15.1)
Other timing differences	(2.7)	(9.8)
Net non-deductible expenses	5.9	2.6
Actual current tax charge for the year	42.9	61.1

9. Dividends

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

	2011 £m	2010 £m
Interim dividend for the year ended 31 March 2011 at 28.1 pence per share (2010: 24.8 pence per share)	262.2	231.2

The directors have not recommended a final ordinary dividend for 2010/11 (2010: £nil).

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

Notes to the financial statements (continued)

At 31 March 2011

10. Tangible fixed assets

	Freehold land and buildings £m	Infra-structure assets £m	Operational structures £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
Cost						
At 1 April 2010	225.7	5,104.5	4,796.0	605.3	852.4	11,583.9
Additions	12.8	195.0	58.2	32.8	333.4	632.2
Grants and contributions	-	(18.4)	-	-	-	(18.4)
Transfers	4.1	81.9	323.1	12.2	(421.3)	-
Disposals	(3.0)	-	(21.4)	(19.3)	-	(43.7)
At 31 March 2011	239.6	5,363.0	5,155.9	631.0	764.5	12,154.0
Depreciation						
At 1 April 2010	72.6	1,813.8	1,512.8	329.8	-	3,729.0
Charge for the year	7.9	141.5	186.8	69.6	-	405.8
Disposals	(2.8)	-	(16.1)	(13.7)	-	(32.6)
At 31 March 2011	77.7	1,955.3	1,683.5	385.7	-	4,102.2
Net book value						
At 31 March 2011	161.9	3,407.7	3,472.4	245.3	764.5	8,051.8
At 31 March 2010	153.1	3,290.7	3,283.2	275.5	852.4	7,854.9

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (see note 1). As a consequence, the cost of tangible fixed assets is £195.8 million (2010: £177.4 million) lower than it would have been had this treatment not been adopted.

Capital commitments	2011 £m	2010 £m
Contracted but not provided for	241.7	382.6

Notes to the financial statements (continued)

At 31 March 2011

11. Fixed asset investments

	Other investments £m
Cost and net book value at 1 April 2010 and 31 March 2011	0.2

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

Other investments	Description of holding	Proportion held	Nature of business
WRc PLC	‘A’ Ordinary shares of £1.00 each	16.97%	Water and wastewater research
	8.0 per cent convertible unsecured loan stock 2014	28.58%	
Paypoint PLC	Ordinary shares of 0.003 pence each	0.02%	Cash collection service
Lingley Mere Management Company Limited	Ordinary (non-voting) shares of £1.00 each	93.27%	Estate management
United Utilities Water Leasing Limited	Ordinary shares of £1.00 each	100.00%	Non-trading

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

Notes to the financial statements (continued)

At 31 March 2011

12. Debtors

(a) Amounts falling due within one year

	2011 £m	2010 £m
Trade debtors	176.9	110.2
Amounts owed by parent and fellow subsidiary undertakings – trading balances	1.9	6.7
Amounts owed by parent and fellow subsidiary undertakings – floating rate loans	40.0	40.0
Other debtors	13.6	13.4
Prepayments and accrued income	77.4	128.7
Derivative financial instruments (see note 20)	2.0	18.3
	311.8	317.3

(b) Amounts falling due after more than one year

	2011 £m	2010 £m
Derivative financial instruments (see note 20)	276.9	270.7

(c) Allowance for bad and doubtful debts

	2011 £m	2010 £m
Allowance at start of year	(191.5)	(179.0)
Amounts charged to operating expenses (see note 3)	(30.2)	(52.9)
Trade debtors written-off	168.3	40.4
Allowance at end of year	(53.4)	(191.5)

During the year ended 31 March 2011, £131.1 million of debt was written off as a result of a detailed review of the company's trade debtors balance. This debt was significantly provided, therefore the charge for bad and doubtful debts as a result of this exercise was a lower amount of £2.5 million.

(d) Ageing of gross debtors

	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2011				
Gross trade debtors	136.2	42.3	51.8	230.3
Amounts owed by parent and fellow subsidiary undertakings	41.9	-	-	41.9
Other debtors	13.6	-	-	13.6
Prepayments and accrued income	77.4	-	-	77.4
	269.1	42.3	51.8	363.2 [1]

[1] Total carrying value excludes derivative financial instruments.

Notes to the financial statements (continued)

At 31 March 2011

12. Debtors (continued)

(d) Ageing of gross debtors (continued)

	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2010				
Gross trade debtors	115.8	58.9	127.0	301.7
Amounts owed by parent and fellow subsidiary undertakings	46.7	-	-	46.7
Other debtors	13.4	-	-	13.4
Prepayments and accrued income	128.7	-	-	128.7
	304.6	58.9	127.0	490.5 [1]

[1] Total carrying value excludes derivative financial instruments.

The above analysis in respect of gross trade debtors reconciles to net trade debtors by deduction of the allowance for doubtful debtors of £53.4 million (2010: £191.5 million). The company manages its bad debt risk by providing against gross trade debtors. This allowance is calculated by reference to customer categories rather than solely on the age profile of gross debtor balances. It is therefore not possible to age the allowance for doubtful debtors.

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

	2011 £m	2010 £m
Debtors in respect of unmetered water supplies	100.8	93.0
Debtors in respect of metered water supplies	113.2	115.0
Other regulated debtors	53.9	44.3
	267.9	252.3

The directors consider that the carrying amount of trade and other debtors approximates to their fair value, at 31 March 2011 and 31 March 2010.

13. Current asset investments

	2011 £m	2010 £m
Short-term deposits	1.6	-

Notes to the financial statements (continued)

At 31 March 2011

14. Creditors: amounts falling due within one year

(a) Trade and other creditors

	2011 £m	2010 £m
Trade creditors	31.9	27.7
Amounts owed to parent and fellow subsidiary undertakings	29.0	24.8
Taxation and social security	34.4	60.1
Deferred grants and contributions (see note 16)	6.4	6.2
Accruals and deferred income	291.5	261.6
Derivative financial instruments (see note 20)	-	25.2
	393.2	405.6

(b) Borrowings

	2011 £m	2010 £m
Bank overdraft	7.4	5.1
Bonds, bank and other term borrowings	50.3	50.2
130,000,000 7.0 per cent £1.00 redeemable preference shares	130.0	130.0
Amounts owed to parent and fellow subsidiary undertakings	23.3	112.0
	211.0	297.3

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

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

(a) Trade and other creditors

	2011 £m	2010 £m
Other creditors	8.1	7.2
Deferred grants and contributions (see note 16)	78.0	80.7
Derivative financial instruments (see note 20)	84.6	87.0
	170.7	174.9

(b) Borrowings

	2011 £m	2010 £m
Bonds, bank and other term borrowings	4,497.2	4,398.2
Amounts owed to parent and fellow subsidiary undertakings	694.5	472.3
	5,191.7	4,870.5

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

Notes to the financial statements (continued)

At 31 March 2011

16. Deferred grants and contributions

	2011 £m	2010 £m
At start of year	86.9	89.7
Received in the year	4.0	3.6
Credited to the profit and loss account (see note 3)	(6.5)	(6.4)
At end of year	84.4	86.9
Represented by:		
Amounts falling due within one year (see note 14a)	6.4	6.2
Amounts falling due after one year (see note 15a)	78.0	80.7
At end of year	84.4	86.9

17. Provisions for liabilities

	Deferred tax: pension (note 21) £m	Deferred tax: other (note 18) £m	Other £m	Total £m
At 1 April 2010	-	329.2	17.6	346.8
At 1 April 2010 – disclosed separately in pensions (see note 21)	(53.1)	-	-	(53.1)
Net profit and loss charge/(credit)	14.8	(3.5)	19.4	30.7
	(38.3)	325.7	37.0	324.4
Tax on actuarial gains on defined benefit pension schemes	1.1	-	-	1.1
Utilised in the year	-	-	(23.9)	(23.9)
At 31 March 2011 – disclosed separately in pensions (see note 21)	37.2	-	-	37.2
At 31 March 2011	-	325.7	13.1	338.8

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

Notes to the financial statements (continued)

At 31 March 2011

18. Deferred tax

Deferred tax is provided as follows:

	2011 £m	2010 £m
Accelerated capital allowances	1,049.7	1,111.4
Short-term timing differences	(14.7)	(29.3)
Undiscounted provision for deferred tax	1,035.0	1,082.1
Discount	(709.3)	(752.9)
Discounted provision for deferred tax (see note 17)	325.7	329.2

19. Borrowings

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

	2011 £m	2010 £m
Non-current liabilities		
Bank and other term borrowings	967.3	932.2
Bonds	3,529.9	3,466.0
Amounts owed to parent and fellow subsidiary undertakings	694.5	472.3
	5,191.7	4,870.5
Current liabilities		
Bank overdraft	7.4	5.1
Bank and other term borrowings	50.3	50.2
130,000,000 7 per cent £1.00 redeemable preference shares	130.0	130.0
Amounts owed to parent and fellow subsidiary undertakings	23.3	112.0
	211.0	297.3
	5,402.7	5,167.8

Notes to the financial statements (continued)

At 31 March 2011

19. Borrowings (continued)

Terms and debt repayment schedule

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

	Currency	Year of final repayment	2011 Fair value £m	2011 Carrying value £m	2010 Fair value £m	2010 Carrying value £m
Borrowings in fair value hedge relationships						
5.75% 375m bond	GBP	2022	390.7	371.6	383.2	367.9
5.625% 300m bond	GBP	2027	310.2	327.7	308.5	326.7
5.00% 200m bond	GBP	2035	186.3	208.2	184.6	208.2
5.375% 150m bond	GBP	2018	163.8	162.8	161.6	163.0
4.25% 500m bond	EUR	2020	436.2	452.0	444.8	467.2
5.02% JPY 10,000m dual currency loan	JPY/USD	2029	73.5	87.9	70.1	84.0
Borrowings designated at fair value through profit or loss						
6.875% 400m bond (owed to intermediate parent undertaking)	USD	2028	264.3	264.3	266.8	266.8
1.135% 3,000m bond	JPY	2013	22.5	22.5	20.8	20.8
Borrowings measured at amortised cost						
Amounts owed to parent and fellow subsidiary undertakings	GBP	Various	453.5	453.5	317.5	317.5
6.125% 425m bond	GBP	2015	472.3	430.9	473.2	432.0
1.97% + RPI 200m IL loan	GBP	2016	207.0	228.5	203.6	217.5
Long term bank borrowings - floating	GBP	2011-12	199.9	200.0	249.9	250.0
Preference shares (owed to immediate parent undertaking)	GBP	2099	130.0	130.0	130.0	130.0
1.9799% + RPI 100m IL bond	GBP	2035	115.3	117.9	100.4	112.6
1.7829% + RPI 100m IL bond	GBP	2040	109.5	116.7	92.3	111.4
1.847% + RPI 100m IL bond	GBP	2056	95.4	116.4	77.8	110.8
1.5802% + RPI 100m IL bond	GBP	2042	102.8	116.3	85.9	111.0
1.815% + RPI 100m IL bond	GBP	2056	94.3	115.9	76.8	110.3
1.662% + RPI 100m IL bond	GBP	2056	89.7	115.7	72.7	110.1
1.585% + RPI 100m IL bond	GBP	2057	87.3	111.3	70.5	105.9
2.40% + RPI 70m IL bond	GBP	2039	73.8	75.1	67.1	71.4
3.375% + RPI 50m IL bond	GBP	2032	79.1	62.6	74.0	59.7
1.3258% + RPI 50m IL bond	GBP	2041	48.5	58.2	40.4	55.6
1.397% + RPI 50m IL bond	GBP	2046	48.2	58.2	40.1	55.5
1.5366% + RPI 50m IL bond	GBP	2043	51.0	58.0	42.5	55.4
1.7937% + RPI 50m IL bond	GBP	2049	55.8	57.9	43.9	55.3
1.5865% + RPI 50m IL bond	GBP	2056	43.7	57.8	35.3	55.0
1.556% + RPI 50m IL bond	GBP	2056	43.5	57.5	35.1	54.7
1.435% + RPI 50m IL bond	GBP	2056	41.6	57.3	33.5	54.5
1.702% + RPI 50m IL bond	GBP	2057	45.6	56.1	36.9	53.4
1.61% + RPI 50m IL loan	GBP	2020	51.5	52.8	49.8	50.2
1.73% + RPI 50m IL loan	GBP	2020	52.0	52.7	50.4	50.2
1.84% + RPI 50m IL loan	GBP	2020	52.4	52.7	50.9	50.1
1.90% + RPI 50m IL loan	GBP	2020	52.8	52.6	51.2	50.1
1.93% + RPI 50m IL loan	GBP	2020	52.9	52.6	51.3	50.0
1.88% + RPI 50m IL loan	GBP	2020	52.7	52.5	51.0	49.9
2.46% + RPI 50m IL loan	GBP	2020	55.3	52.5	53.9	49.9
2.10% + RPI 50m IL loan	GBP	2020	53.7	52.4	52.1	49.9
1.23% + RPI 50m IL loan	GBP	2029	42.9	50.0	-	-
1.3805% + RPI 35m IL bond	GBP	2056	28.5	40.1	22.9	38.2
1.66% +RPI 35m IL bond	GBP	2037	31.7	38.6	28.8	36.7

Notes to the financial statements (continued)

At 31 March 2011

19. Borrowings (continued)

	Currency	Year of final repayment	2011 Fair value	2011 Carrying value	2010 Fair value	2010 Carrying value
			£m	£m	£m	£m
1.30% + LIBOR 5,000m (floating) bond	JPY	2017	41.0	37.8	38.8	35.3
Commission for New Towns loan - fixed	GBP	2053	49.9	30.4	50.9	30.6
1.591% + RPI 25m IL bond	GBP	2056	21.8	28.8	17.6	27.4
Other borrowings						
Bank overdraft	GBP	2011	7.4	7.4	5.1	5.1
			5,181.8	5,402.7	4,814.5	5,167.8

The amount of unamortised bond discount contained within the company's borrowings amounts to £13.5 million (2010: £21.4 million).

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

Currency

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

Index-linked debt

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

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments

Risk management

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

The group treasury committee, a sub-committee of the group board, has responsibility for setting and monitoring the company's adherence to treasury policies, along with oversight in relation to the activities of the treasury function.

Treasury policies cover the key financial risks: liquidity risk, credit risk, market risk (inflation, interest rate, currency and electricity commodity price) and capital risk. These policies are reviewed by the group treasury committee for approval on at least an annual basis, or following any major changes in treasury operations and/or financial market conditions.

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

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

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

Liquidity risk

Liquidity risk is the risk that the company will not have the appropriate level of liquid funding available to meet its requirements. Maintaining an inadequate amount of liquidity and being unable to access the debt markets when required exposes the company to the risk of insolvent trading, whilst maintaining excess liquidity potentially exposes the company to the risk of a higher cost of carry resulting in an adverse economic impact.

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

At 31 March 2011, the company had £627.2 million (2010: £400.3 million) of available liquidity, which comprised £1.9 million (2010: £0.3 million) cash and short-term deposits and £625.3 million (2010: £400.0 million) of undrawn committed borrowing facilities. Short-term deposits mature within three months and bank overdraft are repayable on demand.

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

	2011 £m	2010 £m
Expiring within one year	125.0	25.0
Expiring after one year but in less than two years [(1)]	575.0	125.0
Expiring after more than two years	150.0	250.0
Total borrowing facilities	850.0	400.0
Facilities drawn	(224.7)	-
Undrawn borrowing facilities	625.3	400.0

[(1)] 2011 figure includes £450.0 million facility provided by parent undertaking.

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Liquidity risk (continued)

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

In addition to the committed facilities available, the company can use its €2 billion euro-commercial paper programme to help manage its liquidity position.

Maturity analysis

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

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

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

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

At 31 March 2010	Total[1] £m	Adjustment [2] £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Bonds	9,048.8	-	128.9	129.7	130.6	153.9	132.4	8,373.3
Bank borrowings and other	1,449.3	-	77.2	72.9	170.9	20.2	20.5	1,087.6
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,112.9	-	132.7	22.0	24.4	26.0	26.9	880.9
Adjustment to carrying value	(6,573.2)	(6,573.2)	-	-	-	-	-	-
Financial liabilities excluding derivatives	5,167.8	(6,573.2)	468.8	224.6	325.9	200.1	179.8	10,341.8
Derivatives								
Payable	902.1	-	86.3	64.7	56.3	70.3	46.6	577.9
Receivable	(1,160.1)	-	(99.6)	(79.5)	(73.3)	(90.6)	(76.0)	(741.1)
Adjustment to carrying value	81.2	81.2	-	-	-	-	-	-
Derivatives – net assets	(176.8)	81.2	(13.3)	(14.8)	(17.0)	(20.3)	(29.4)	(163.2)

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

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

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Credit risk

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from trade finance (the supply of services to the public and other businesses) and treasury activities (the depositing of cash and holding derivative and foreign exchange instruments). The company does not believe it is exposed to any material concentrations of credit risk.

The company manages its risk from trade finance through the effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the company's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. Considering the above, the directors believe there is no further credit risk provision required in excess of the allowance for doubtful receivables (see note 12).

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

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

	2011 £m	2010 £m
Cash and short-term deposits	1.9	0.3
Trade and other debtors	309.8	299.0
Derivative financial instruments	278.9	289.0
	590.6	588.3

Market risk

Market risk is the risk that movements in market rates, including inflation, interest rates, foreign exchange rates and electricity commodity prices, will result in economic losses to the company.

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

The company uses a variety of financial instruments, including derivatives, in order to manage the exposure to these risks. As at the year ended 31 March 2011, there were no financial instruments in place in relation to electricity commodity prices.

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Inflation risk

The company 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 company to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt.

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

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

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

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

	2011 £m	2010 £m
Index-linked debt	2,215.7	2,062.7

The sensitivity analysis set out below has been prepared on the basis of the amount of index-linked debt in place as at 31 March 2011 and 31 March 2010, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI on the company's index-linked borrowings.

Impact on profit before taxation and equity

	2011 £m	2010 £m
1 per cent increase in RPI	(22.6)	(21.1)
1 per cent decrease in RPI	22.6	21.1

Brackets denote a reduction in profit.

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

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

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Interest rate risk

The company's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The company's floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The company uses interest rate swap contracts to hedge these exposures where appropriate.

The company's policy is to structure debt in a way that best matches its underlying assets and cash flows. The regulated business earns an economic return on its RCV, comprising a real return through 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 exposure to medium-term interest rates, the company has fixed interest costs for a substantial proportion of the company's net debt for the duration of the current five-year regulatory pricing period.

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

Sensitivity analysis

The sensitivity analysis below has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2011 and 31 March 2010, respectively. As a result, this analysis is not indicative of the years then ended, as these factors would have varied throughout the year.

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

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

Impact on profit before taxation and equity

	2011 £m	2010 £m
1 per cent increase in interest rate	73.1	75.8
1 per cent decrease in interest rate	(77.4)	(82.0)

Brackets denote a reduction in profit.

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Interest rate risk (continued)

The exposure largely relates to the fair value exposure on the company's fixed rate financing, which provides a partial economic hedge that is aligned to the five-year revenue cash flows allowed by the regulator.

Repricing analysis

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

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

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

At 31 March 2010	Total	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Borrowings in hedge relationships							
Fixed rate instruments	1,617.0	-	-	-	-	-	1,617.0
Effect of swaps	-	1,617.0	-	-	-	-	(1,617.0)
	1,617.0	**1,617.0**	**-**	**-**	**-**	**-**	**-**
Borrowings designated at fair value through profit or loss							
Fixed rate instruments	287.6	-	-	-	20.8	-	266.8
Effect of swaps	-	287.6	-	-	(20.8)	-	(266.8)
	287.6	**287.6**	**-**	**-**	**-**	**-**	**-**
Borrowings measured at amortised cost							
Fixed rate instruments	592.6	0.2	0.3	0.3	0.3	0.3	591.2
Floating rate instruments	607.9	607.9	-	-	-	-	-
Index-linked instruments	2,062.7	2,062.7	-	-	-	-	-
	3,263.2	**2,670.8**	**0.3**	**0.3**	**0.3**	**0.3**	**591.2**
Effect of a fixed hedge for the term of the regulatory period	-	(1,831.3)	-	-	-	1,381.3	450.0
Total borrowings	**5,167.8**	**2,744.1**	**0.3**	**0.3**	**0.3**	**1,381.6**	**1,041.2**
Cash and short-term deposits	(0.3)	(0.3)	-	-	-	-	-
Net borrowings	**5,167.5**	**2,743.8**	**0.3**	**0.3**	**0.3**	**1,381.6**	**1,041.2**

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

Currency risk

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

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

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

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

Capital risk management

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

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

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

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

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 (continued)

At 31 March 2011

20. Financial instruments (continued)

Fair values

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

	2011 Fair value £m	2011 Carrying value £m	2010 Fair value £m	2010 Carrying value £m
Financial assets				
Non-current assets				
Derivative financial instruments:				
Fair value hedge derivatives	180.8	180.8	186.0	186.0
Held for trading derivatives [2] [3]	96.1	96.1	84.7	84.7
Total non-current assets	276.9	276.9	270.7	270.7
Current assets				
Cash and short-term deposits	1.9	1.9	0.3	0.3
Trade and other debtors	309.8	309.8	299.0	299.0
Derivative financial instruments:				
Held for trading derivatives [2]	2.0	2.0	18.3	18.3
Total current assets	313.7	313.7	317.6	317.6
Financial liabilities				
Non-current liabilities				
Trade and other creditors	(86.1)	(86.1)	(87.9)	(87.9)
Borrowings:				
Financial liabilities in a hedge relationship	(1,560.7)	(1,610.2)	(1,552.8)	(1,617.0)
Financial liabilities designated at fair value through profit or loss	(286.8)	(286.8)	(287.6)	(287.6)
Financial liabilities measured at amortised cost	(3,123.3)	(3,294.7)	(2,676.8)	(2,965.9)
	(4,970.8)	(5,191.7)	(4,517.2)	(4,870.5)
Derivative financial instruments:				
Fair value hedge derivatives	(2.3)	(2.3)	(5.0)	(5.0)
Held for trading derivatives [2]	(82.3)	(82.3)	(82.0)	(82.0)
Total non-current liabilities	(5,141.5)	(5,362.4)	(4,692.1)	(5,045.4)
Current liabilities				
Trade and other creditors	(393.2)	(393.2)	(380.4)	(380.4)
Borrowings:				
Financial liabilities measured at amortised cost	(211.0)	(211.0)	(297.3)	(297.3)
Derivative financial instruments:				
Held for trading derivatives [2]	-	-	(25.2)	(25.2)
Total current liabilities	(604.2)	(604.2)	(702.9)	(702.9)
Adjustment for accrued interest [1]	34.7	-	(34.2)	-
Net financial liabilities	(5,120.4)	(5,376.0)	(4,840.9)	(5,160.0)

[1] Fair values quoted include accrued interest of £34.7 million (2010: £34.2 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other creditors. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

[2] Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £85.3 million (2010: £100.3 million).

[3] Includes amount owed by parent undertaking £12.8 million (2010: £nil).

Notes to the financial statements (continued)

At 31 March 2011

20. Financial instruments (continued)

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

In respect of the total change during the year in the fair value of financial liabilities designated as at fair value through profit or loss of £0.8 million gain (2010: £7.9 million loss), a £4.1 million loss (2010: £48.2 million loss) is attributable to changes in own credit risk. The cumulative impact of changes in credit spread was £54.9 million profit (2010: £59.0 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £62.6 million (2010: a carrying amount increase of £63.4 million).

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

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

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

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

	Level 1 £m	Level 2 £m	Level 3 £m	2010 Total £m
Financial assets at fair value through profit or loss				
Derivative financial assets	-	289.0	-	289.0
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	(112.2)	-	(112.2)
Financial liabilities designated as fair value through profit or loss	-	(287.6)	-	(287.6)
	-	(110.8)	-	(110.8)

Notes to the financial statements (continued)

At 31 March 2011

21. Retirement benefits

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

The last actuarial valuation of UUPS and ESPS were carried out as at 31 March 2010. These valuations have been updated to take account of the requirements of FRS 17 'Retirement benefits' in order to assess the position at 31 March 2011 by projecting forward from the dates of the respective valuations, and have been performed by an independent actuary, Mercer Limited.

UUPS has entered into an inflation mechanism with the company as part of the funding and de-risking measures that have taken place during the year. The mechanism is based upon a long-term fixed inflation assumption for the scheme valuation of 2.75 per cent per annum. In periods when actual inflation is higher than 2.75 per cent, the company will make additional contributions (smoothed over a five-year period) in respect of the increased liabilities caused by higher inflation. Given the company, via its regulated capital structure, has a natural hedge against inflation, management believes that this is an appropriate structure to have put in place. This has been entered into as part of a de-risking mandate agreed with the Pension Trustee, including reducing equity and interest rate risks and is aimed at reducing the volatility in future funding and contributions. Whilst this reduces the pension scheme funding risk, it should be noted that it will not necessarily have a similar impact on the FRS 17 basis pension disclosures. FRS 17 assumptions are based upon current market expectations and will remain subject to market related inflation rates at future reporting dates. It should therefore be noted, in particular, that any disclosed FRS 17 material increases to market related inflation expectations will continue to negatively impact the disclosed FRS 17 basis position.

The company made total contributions of £60.6 million (2010: £7.9 million) to its pension schemes for the year ended 31 March 2011; United Utilities Water PLC having recommenced company contributions from 1 April 2010. As previously reported, on 31 March 2005, the company made lump sum payments of £110.9 million and £2.9 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that were expected to have been payable for defined benefit members over the five years from 1 April 2005. Whilst some company contributions to UUPS and ESPS resumed in respect of the defined benefit members during 2008/09, significant elements of the company contribution holiday following the lump sum payments continued during the year ended 31 March 2010.

Overall, the company expects to contribute around £53.1 million to its defined benefit schemes in the year ending 31 March 2012.

The company's total defined benefit pension expense for the year was £18.2 million (2010: £35.9 million income), including pension income credited to operating profit of £14.0 million (2010: £51.5 million income) which reflects curtailment gains arising on reorganisation of £3.8 million (2010: £8.3 million). The prior year figure reflects the curtailment gains arising on amendment of pension obligations of £76.7 million. A pension obligation of £105.7 million, net of deferred tax of £37.2 million, is included in the balance sheet at 31 March 2011 (2010: obligation of £136.6 million, net of deferred tax of £53.1 million).

The credit of £76.7 million offsetting the pension expense for the year ended 31 March 2010 arose as a result of the amendment of pensions obligations. These include the introduction of a restriction on the rate of increase in pensionable pay for defined benefit members of the UUPS and the ESPS. This restriction took effect on 31 March 2010. Changes to the benefits accruing after 31 March 2010 for the defined benefit members of the UUPS have also been implemented. The impact of these changes has been reflected in the current service cost element of the pension expense for 2010/11.

Notes to the financial statements (continued)

At 31 March 2011

21. Retirement benefits (continued)

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

	2011 % p.a.	2010 % p.a.	2009 % p.a.
Discount rate	5.50	5.70	7.00
Expected return on assets – UUPS	5.65	6.20	6.60
Expected return on assets – ESPS	6.10	6.30	6.20
Pensionable salary growth	3.35	3.30	4.15
Pension increases	3.35	3.30	3.20
Price inflation	3.35	3.30	3.20

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

	2011 years	2010 years	2009 years
Retired member – male	25.1	24.9	24.9
Non-retired member – male	26.6	26.0	26.0
Retired member – female	28.9	28.0	28.0
Non-retired member – female	30.4	28.7	28.7

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

	Schemes' assets at 31 March 2011 %	Long-term rate of return expected at 31 March 2011 %	At 31 March 2011 £m	Schemes' assets at 31 March 2010 %	Long-term rate of return expected at 31 March 2010 %	At 31 March 2010 £m
Equities	31.3	7.2	344.4	47.4	7.4	476.7
Gilts	0.6	4.2	7.1	5.4	4.4	54.2
Bonds	49.0	5.3	540.1	47.1	5.2	473.7
Other	19.1	4.2	210.7	0.1	0.5	1.0
Total fair value of assets	100.0		1,102.3	100.0		1,005.6
Present value of liabilities			(1,245.2)			(1,195.3)
Pension liability			(142.9)			(189.7)
Related deferred tax asset (see note 17)			37.2			53.1
Net pension liability			(105.7)			(136.6)

Notes to the financial statements (continued)

At 31 March 2011

21. Retirement benefits (continued)

Details in respect of 2009 are as follows:

	Schemes' assets at 31 March 2009 %	Long-term rate of return expected at 31 March 2009 %	At 31 March 2009 £m
Equities	55.9	7.0	445.9
Gilts	5.8	4.0	46.3
Bonds	37.8	6.4	301.6
Property	0.1	7.0	0.2
Other	0.4	0.5	3.0
Total fair value of assets	100.0		797.0
Present value of liabilities			(961.1)
Pension liability			(164.1)
Related deferred tax asset			46.0
Net pension liability			(118.1)

During the year, all the employees of United Utilities Property Services Limited transferred to UUW. The pension schemes' obligations relating to these employees transferred to UUW at the same time. The difference between the pension schemes' assets and liabilities in respect of the transfer of these employees' past service has been included in the income statement as a 'settlement' and is described as a business combination in the tables above.

To develop the expected long-term rate of return on asset assumptions, the company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based upon the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The company's actual return on schemes' assets was a gain of £77.2 million (2010: £249.4 million).

The assets as at 31 March 2011, in respect of the UUPS, included in the breakdown on the previous page, have been allocated to each asset class based upon the return the assets are expected to achieve and not based upon the physical assets held. The reason for this is that during the year to 31 March 2011 the UUPS entered into a variety of derivative transactions in order to change the return characteristics of the physical assets held and in order to reduce undesirable market and liability risks.

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

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

	2011 £m	2010 £m
At start of year	(1,195.3)	(961.1)
Interest cost on schemes' obligations	(67.1)	(66.4)
Actuarial losses	(9.9)	(268.0)
Curtailments/settlements:		
arising on reorganisation	(0.9)	(8.3)
arising on amendment of pension obligations	-	76.7
Member contributions	(5.8)	(5.6)
Benefits paid	53.2	54.3
Current service cost	(10.2)	(14.3)
Past service cost	-	(2.6)
Business combinations	(9.2)	-
At end of year	(1,245.2)	(1,195.3)

Notes to the financial statements (continued)

At 31 March 2011

21. Retirement benefits (continued)

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

	2011 £m	2010 £m
At start of year	1,005.6	797.0
Expected return on schemes' assets	62.9	50.8
Actuarial gains	14.3	198.6
Member contributions	5.8	5.6
Benefits paid	(53.2)	(54.3)
Company contributions	60.6	7.9
Business combinations	6.3	-
At end of year	1,102.3	1,005.6

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

	2011 £m	2010 £m
Current service cost	(10.2)	(14.3)
Curtailments/settlements:		
arising on reorganisation	(3.8)	(8.3)
arising on amendment of pension obligations	-	76.7
Past service cost	-	(2.6)
Pension (expense)/income (charged)/credited to operating profit	(14.0)	51.5
Expected return on schemes' assets	62.9	50.8
Interest on schemes' liabilities	(67.1)	(66.4)
Pension expense charged to net interest payable and similar charges (see note 7)	(4.2)	(15.6)
Net pension (expense)/income (charged)/credited before taxation	(18.2)	35.9

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

	2011 £m	2010 £m
At start of year	(189.7)	(164.1)
(Expense)/income recognised in the profit and loss account	(18.2)	35.9
Contributions paid	60.6	7.9
Actuarial gains/(losses) gross of taxation	4.4	(69.4)
At end of year	(142.9)	(189.7)

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses. At 31 March 2011, a cumulative pre-tax loss of £119.2 million (2010: £123.6 million) had been recorded directly in the statement of total recognised gains and losses.

Notes to the financial statements (continued)

At 31 March 2011

21. Retirement benefits (continued)

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

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Present value of defined benefit obligations	(1,245.2)	(1,195.3)	(961.1)	(1,101.2)	(1,109.4)
Fair value of schemes' assets	1,102.3	1,005.6	797.0	1,033.7	1,126.2
Net retirement benefit obligations	(142.9)	(189.7)	(164.1)	(67.5)	16.8
Experience adjustments on schemes' liabilities (£)	39.5	3.2	(13.9)	14.3	28.7
Percentage of scheme liabilities (%)	3.2	(0.3)	1.4	(1.3)	(2.6)
Experience adjustments on schemes' assets (£)	14.3	198.6	(270.6)	(131.4)	(7.3)
Percentage of scheme assets (%)	1.3	19.7	(34.0)	(12.7)	(0.6)

During the year, the company made £3.4 million (2010: £2.6 million) of contributions to defined contribution schemes.

22. Called up share capital and share premium account

	2011 £m	2010 £m
Allotted and fully paid share capital		
931,930,000 ordinary shares of £1.00 each	931.9	931.9
93,437,000 zero per cent preference shares of £1.00 each	93.4	93.4
130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each	130.0	130.0
	1,155.3	1,155.3
Less: 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each designated as borrowings (see note 19)	(130.0)	(130.0)
	1,025.3	1,025.3
Share premium account	647.8	647.8

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

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

Notes to the financial statements (continued)

At 31 March 2011

23. Share capital and reserves

	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m
At 1 April 2010	1,025.3	647.8	542.3	2,215.4
Profit after taxation	-	-	279.6	279.6
Actuarial gains on defined benefit pension schemes	-	-	4.4	4.4
Deferred tax credit arising on actuarial gains on defined benefit pension schemes	-	-	(1.1)	(1.1)
Dividends paid on equity shares	-	-	(262.2)	(262.2)
At 31 March 2011	1,025.3	647.8	563.0	2,236.1

24. Operating leases

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

	Land and buildings 2011 £m	Plant and machinery 2011 £m	Land and buildings 2010 £m	Plant and machinery 2010 £m
Non-cancellable operating leases which expire:				
Within one year	0.3	0.1	0.2	0.2
Between two and five years	0.2	0.5	0.3	0.4
After five years	2.1	-	2.6	-
	2.6	0.6	3.1	0.6

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

	2011 £m	2010 £m
Operating profit	587.8	788.0
Depreciation	405.8	343.7
Amortisation of grants and contributions	(6.5)	(6.4)
Loss/(profit) on disposal of tangible fixed assets	1.1	(4.0)
Increase in stocks	(0.9)	-
(Increase)/decrease in debtors	(10.8)	11.0
Increase/(decrease) in creditors	17.3	(9.8)
Movement in other provisions (including pension liability)	(51.1)	(52.0)
Net cash inflow from operating activities	942.7	1,070.5

Notes to the financial statements (continued)

At 31 March 2011

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

	2011 £m	2010 £m
Decrease in cash in the year	-	(0.8)
(Increase)/decrease in overdraft in the year	(2.3)	6.1
Net cash (inflow)/outflow from (increase)/decrease in debt and lease financing	(118.3)	2.2
Net cash outflow/(inflow) from increase/(decrease) in liquid resources	1.6	(80.0)
Net cash (inflow)/outflow from derivatives [1]	(9.1)	11.5
Changes in net debt resulting from cash flows	(128.1)	(61.0)
Non-cash adjustments	(87.7)	(169.7)
Movement in net debt in the year	(215.8)	(230.7)
Net debt at 1 April	(4,950.7)	(4,720.0)
Net debt at 31 March	(5,166.5)	(4,950.7)

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

[1] Cash flows on derivatives consist of £0.7 million financing inflow (2010: £0.8 million inflow) (see note 27) and £8.4 million interest inflow (2010: £12.3 million outflow).

27. Financing

	2011 £m	2010 £m
New loans	569.0	303.6
Loans repaid	(433.0)	(288.4)
	136.0	15.2
Financing cash flows on derivatives	0.7	0.8
Net cash inflow from financing	136.7	16.0

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

Notes to the financial statements (continued)

At 31 March 2011

28. Analysis of changes in net debt

	At 1 April 2010 £m	Cash flow £m	Non-cash movements £m	At 31 March 2011 £m
Cash	0.3	-	-	0.3
Overdraft	(5.1)	(2.3)	-	(7.4)
Parent and fellow subsidiary undertaking loans	40.0	-	-	40.0
	35.2	(2.3)	-	32.9
Debt due after one year	(4,870.5)	(177.0)	(144.2)	(5,191.7)
Debt due within one year	(292.2)	58.7	29.9	(203.6)
	(5,162.7)	(118.3)	(114.3)	(5,395.3)
Current asset investments	-	1.6	-	1.6
Net debt excluding derivatives	(5,127.5)	(119.0)	(114.3)	(5,360.8)
Derivatives	176.8	(9.1)	26.6	194.3
Net debt including derivatives	(4,950.7)	(128.1)	(87.7)	(5,166.5)

29. Related party transactions

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

	2011 £m	2010 £m
Sales of services	0.2	0.2
Purchases of goods and services	0.3	0.5

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

No guarantees have been given or received. No amounts have been written-off during the year (2010: £nil).

30. Ultimate parent undertaking and controlling party

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

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

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

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

Regulated accounting information

Introduction

The Regulatory Accounts on pages 85 to 109 have been prepared in accordance with the requirements of Regulatory Accounting Guidelines issued by the Water Services Regulation Authority ('WSRA').

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

The business review has been presented on pages 8 to 27.

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

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

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This approach, taking into account the relatively stable and regulated nature of the business, is based, amongst other matters, upon a review of the company's budget for 2011/12, the company's five-year business plan and investment programme, together with a review of the cash and committed borrowing facilities available to the company (discussed in further detail in the liquidity and capital resources overview section and the debt financing and interest rate management section on page 16). That review gives details of the company's headroom as at 31 March 2011.

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

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

Independent auditor's report

To the Water Services Regulation Authority and directors of United Utilities Water PLC

We have audited the Regulatory Accounts of United Utilities Water PLC for the year ended 31 March 2011 on pages 85 to 109 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and

- the regulatory current cost accounting statements for the appointed business, comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies.

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

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

Respective responsibilities of the WSRA, the directors and auditor

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

Scope of the audit of the Regulatory Accounts

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

Independent auditor’s report (continued)

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

Opinion on Regulatory Accounts

In our opinion, the Regulatory Accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on pages 91 to 93, the state of the Company’s affairs at 31 March 2011 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies.

Basis of preparation

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

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice (‘UK GAAP’). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. Furthermore, the regulatory historical cost accounting statements on pages 85 to 87 have been drawn up in accordance with Regulatory Accounting Guideline 3.06, in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given in note 11 on pages 106 to 108.

Opinion on other matters prescribed by Condition F

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

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

Independent auditor’s report (continued)

Other matters

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

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2011 on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our ‘statutory audit’) was made solely to the Company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the Company’s members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

For and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, United Kingdom
Date: 30 June 2011

Historical cost profit and loss account

For the year ended 31 March 2011

	Note	2011 Appointed £m	2011 Non-appointed £m	2011 Total £m	2010 Appointed £m	2010 Non-appointed £m	2010 Total £m
Turnover		1,506.6	8.7	1,515.3	1,549.8	8.5	1,558.3
Operating costs (including exceptional costs of £11.9 million (2010: net exceptional credits of £60.9 million))		(664.1)	(3.8)	(667.9)	(545.9)	(4.3)	(550.2)
Historical cost depreciation		(255.7)	(0.1)	(255.8)	(218.9)	-	(218.9)
Operating (expense)/income		(1.1)	-	(1.1)	4.0	-	4.0
Operating profit		585.7	4.8	590.5	789.0	4.2	793.2
Other income	4	1.0	-	1.0	1.0	-	1.0
Net interest		(254.0)	-	(254.0)	(349.3)	-	(349.3)
Profit on ordinary activities before taxation		332.7	4.8	337.5	440.7	4.2	444.9
Current tax		(42.6)	(1.4)	(44.0)	(60.2)	(1.2)	(61.4)
Deferred tax		(12.1)	-	(12.1)	25.8	-	25.8
Taxation on profit on ordinary activities		(54.7)	(1.4)	(56.1)	(34.4)	(1.2)	(35.6)
Profit for the year		278.0	3.4	281.4	406.3	3.0	409.3
Dividends		(259.2)	(3.0)	(262.2)	(228.6)	(2.6)	(231.2)
Retained profit for the year		18.8	0.4	19.2	177.7	0.4	178.1

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

Exceptional costs of £11.9 million (2010: exceptional credits of £60.9 million) comprise other reorganisation costs of £7.0 million (2010: £nil), restructuring costs of £2.1 million (2010: £15.8 million) relating to staff severance and pension schemes' curtailment losses arising on reorganisation of £2.8 million (2010: £nil). In the prior year, these were offset by pension schemes curtailment gains arising on amendment of pension obligations of £76.7 million. There were no equivalent credits in the current year.

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

For the year ended 31 March 2011

	2011 £m	2010 £m
Profit for the year (before dividends)	278.0	406.3
Actuarial gains/(losses) on defined benefit pension schemes (net of deferred taxation)	3.3	(50.0)
Total recognised gains and losses for the year	281.3	356.3

Historical cost balance sheet

At 31 March 2011

	2011 Appointed £m	2011 Non - appointed £m	2011 Total £m	2010 Appointed £m	2010 Non - appointed £m	2010 Total £m
Fixed assets						
Tangible fixed assets	7,984.0	1.2	7,985.2	7,788.8	-	7,788.8
Investments – other	0.2	-	0.2	0.2	-	0.2
Total fixed assets	7,984.2	1.2	7,985.4	7,789.0	-	7,789.0
Current assets						
Stocks	4.6	-	4.6	3.7	-	3.7
Debtors	602.7	5.5	608.2	603.3	4.4	607.7
Cash	0.3	-	0.3	0.3	-	0.3
Short-term deposits	41.6	-	41.6	40.0	-	40.0
Infrastructure renewals prepayment	7.2	-	7.2	5.4	-	5.4
Total current assets	656.4	5.5	661.9	652.7	4.4	657.1
Creditors: amounts falling due within one year						
Overdraft	(7.4)	-	(7.4)	(5.1)	-	(5.1)
Creditors	(409.9)	(1.8)	(411.7)	(396.5)	(0.2)	(396.7)
Borrowings	(73.6)	-	(73.6)	(162.2)	-	(162.2)
Corporation tax payable	(30.8)	(1.4)	(32.2)	(55.9)	(1.2)	(57.1)
Preference share dividends payable	-	-	-	(4.5)	-	(4.5)
Total creditors	(521.7)	(3.2)	(524.9)	(624.2)	(1.4)	(625.6)
Net current assets	134.7	2.3	137.0	28.5	3.0	31.5
Total assets less current liabilities	8,118.9	3.5	8,122.4	7,817.5	3.0	7,820.5
Creditors: amounts falling due after one year						
Borrowings	(5,191.7)	-	(5,191.7)	(4,870.5)	-	(4,870.5)
Other creditors	(92.7)	-	(92.7)	(94.3)	-	(94.3)
Total creditors	(5,284.4)	-	(5,284.4)	(4,964.8)	-	(4,964.8)
Provisions for liabilities and charges						
Deferred tax provision	(314.1)	-	(314.1)	(316.7)	-	(316.7)
Other provisions	(13.1)	-	(13.1)	(17.5)	-	(17.5)
Deferred income – grants and contributions	(84.4)	-	(84.4)	(86.8)	-	(86.8)
Post employment liabilities	(105.7)	-	(105.7)	(136.6)	-	(136.6)
Preference share capital	(130.0)	-	(130.0)	(130.0)	-	(130.0)
Net assets employed	2,187.2	3.5	2,190.7	2,165.1	3.0	2,168.1
Capital and reserves						
Called up equity share capital	1,025.4	-	1,025.4	1,025.4	-	1,025.4
Share premium	647.8	-	647.8	647.8	-	647.8
Profit and loss account	514.0	3.5	517.5	491.9	3.0	494.9
Capital and reserves	2,187.2	3.5	2,190.7	2,165.1	3.0	2,168.1

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

Current cost profit and loss account for the appointed business

For the year ended 31 March 2011

	Note	2011 £m	2010 £m
Turnover	2	1,506.6	1,549.8
Operating costs (including exceptional costs of £11.9 million (2010: net exceptional credits of £60.9 million))	3	(1,051.7)	(885.7)
Operating (expense)/income	2	(4.0)	3.7
		450.9	667.8
Working capital adjustment	2	1.5	3.4
Current cost operating profit		452.4	671.2
Other income	4	1.0	1.0
Net interest		(254.0)	(349.3)
Financing adjustment		167.3	135.2
Current cost profit on ordinary activities before taxation		366.7	458.1
Current tax		(42.6)	(60.2)
Deferred tax		(12.1)	25.8
Taxation on current cost profit on ordinary activities		(54.7)	(34.4)
Current cost profit attributable to shareholders		312.0	423.7
Dividends		(259.2)	(228.6)
Current cost profit retained		52.8	195.1

Exceptional costs of £11.9 million (2010: exceptional credits of £60.9 million) comprise other reorganisation costs of £7.0 million (2010: £nil), restructuring costs of £2.1 million (2010: £15.8 million) relating to staff severance and pension schemes' curtailment losses arising on reorganisation of £2.8 million (2010: £nil). In the prior year, these were offset by pension schemes curtailment gains arising on amendment of pension obligations of £76.7 million. There were no equivalent credits in the current year.

Current cost balance sheet for the appointed business

At 31 March 2011

	Note	2011 £m	2010 £m
Fixed assets			
Tangible assets	5	56,037.5	53,073.4
Third party contributions since 1989/90		(553.3)	(464.1)
		55,484.2	52,609.3
Working capital	7	(56.3)	(28.7)
Cash		0.3	0.3
Short-term deposits		41.6	40.0
Overdraft		(7.4)	(5.1)
Infrastructure renewals prepayment		7.2	5.4
Net operating assets		55,469.6	52,621.2
Non-operating assets and liabilities			
Borrowings		(73.6)	(162.2)
Non-trade debtors		292.3	302.4
Non-trade creditors		(38.7)	(63.1)
Investments – other		0.2	0.2
Corporation tax payable		(30.8)	(55.9)
Preference share dividends payable		-	(4.5)
Total non-operating assets and liabilities		149.4	16.9
Creditors: amounts falling due after more than one year			
Borrowings		(5,191.7)	(4,870.5)
Other creditors		(92.7)	(94.3)
Total creditors falling due after more than one year		(5,284.4)	(4,964.8)
Provisions for liabilities and charges			
Deferred tax provision		(314.1)	(316.7)
Post employment liabilities		(105.7)	(136.6)
Other provisions		(13.1)	(17.5)
Total provisions		(432.9)	(470.8)
Preference share capital		(130.0)	(130.0)
Net assets		49,771.7	47,072.5
Capital and reserves			
Called up equity share capital		1,025.4	1,025.4
Share premium		647.8	647.8
Profit and loss account		(622.3)	(678.3)
Current cost reserve	8	48,720.8	46,077.6
Total capital and reserves		49,771.7	47,072.5

Current cost cash flow statement

For the year ended 31 March 2011

	2011 Appointed £m	2011 Non-appointed £m	2011 Total £m	2010 Appointed £m	2010 Non-appointed £m	2010 Total £m
Current cost operating profit	452.4	4.8	457.2	671.2	4.2	675.4
Working capital adjustment	(1.5)	-	(1.5)	(3.4)	-	(3.4)
Increase/(decrease) in working capital	1.4	0.3	1.7	(11.7)	(0.6)	(12.3)
Receipts from other income	2.7	-	2.7	5.0	-	5.0
Current cost depreciation (net of amortisation of deferred contributions)	387.6	-	387.6	339.8	-	339.8
Current cost loss/(profit) on sale of fixed assets	4.0	-	4.0	(3.7)	-	(3.7)
Infrastructure renewals charge	140.3	-	140.3	109.1	-	109.1
Other non-cash profit and loss items	(49.8)	-	(49.8)	(39.4)	-	(39.4)
Net cash inflow from operating activities	937.1	5.1	942.2	1,066.9	3.6	1,070.5
Returns on investments and servicing of finance						
Interest received	0.2	-	0.2	8.0	-	8.0
Interest paid	(162.1)	-	(162.1)	(193.9)	-	(193.9)
Non-equity dividends paid	(13.6)	-	(13.6)	(4.6)	-	(4.6)
Net cash outflow from returns on investments and servicing of finance	(175.5)	-	(175.5)	(190.5)	-	(190.5)
Taxation paid	(67.8)	(1.0)	(68.8)	(102.0)	(1.0)	(103.0)
Capital expenditure						
Gross cost of purchase of fixed assets	(452.9)	(1.1)	(454.0)	(500.7)	-	(500.7)
Receipt of grants and contributions	13.5	-	13.5	10.2	-	10.2
Infrastructure renewals expenditure	(142.1)	-	(142.1)	(150.1)	-	(150.1)
Disposal of fixed assets	9.5	-	9.5	4.1	-	4.1
Net cash outflow from investing activities	(572.0)	(1.1)	(573.1)	(636.5)	-	(636.5)
Equity dividends paid	(259.2)	(3.0)	(262.2)	(228.6)	(2.6)	(231.2)
Management of liquid resources						
Net cash (outflow)/inflow from management of liquid resources	(1.6)	-	(1.6)	825.2	-	825.2
Net cash (outflow)/inflow before financing	(139.0)	-	(139.0)	734.5	-	734.5
Financing						
New bank loans	569.7	-	569.7	304.4	-	304.4
Repayment of bank loans	(433.0)	-	(433.0)	(1,033.6)	-	(1,033.6)
Net cash inflow/(outflow) from financing	136.7	-	136.7	(729.2)	-	(729.2)
(Decrease)/increase in cash and overdraft	(2.3)	-	(2.3)	5.3	-	5.3

Notes to the current cost accounts

At 31 March 2011

1. Accounting policies

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

Tangible fixed assets

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

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

Operational assets

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

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

Infrastructure assets

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

Other fixed assets

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

Surplus land

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

Capitalisation policy

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

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

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

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

Grants and other third party contributions

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

Notes to the current cost accounts (continued)

At 31 March 2011

1. Accounting policies (continued)

Real financial capital maintenance adjustments

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

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

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

Allocation of costs to principal services

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

Amounts given to charitable trusts assisting customers

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

Appointed and non-appointed activities

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

Revenue recognition

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

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

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

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

Notes to the current cost accounts (continued)

At 31 March 2011

1. Accounting policies (continued)

Revenue recognition (continued)

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

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

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

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

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

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

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

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

Notes to the current cost accounts (continued)

At 31 March 2011

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

	Water supply £m	Sewerage services £m	2011 Appointed business £m	Water supply £m	Sewerage services £m	2010 Appointed business £m
Turnover						
Unmeasured	366.5	393.0	759.5	362.8	438.0	800.8
Measured	257.3	359.1	616.4	244.0	368.7	612.7
Trade effluent	-	20.6	20.6	-	21.3	21.3
Large user and special agreement	50.1	45.7	95.8	50.9	47.0	97.9
Revenue grants	-	0.2	0.2	-	0.4	0.4
Third party services:						
Non-potable large user and special agreement	6.6	-	6.6	6.1	-	6.1
Bulk supplies/intercompany payments	0.8	-	0.8	0.5	-	0.5
Other appointed business (third party)	1.8	0.1	1.9	5.2	-	5.2
Third party services - subtotal	9.2	0.1	9.3	11.8	-	11.8
Other sources	2.8	2.0	4.8	2.7	2.2	4.9
Total turnover	685.9	820.7	1,506.6	672.2	877.6	1,549.8
Operating (expense)/income						
Current cost (loss)/profit on disposal of fixed assets	(0.9)	(3.1)	(4.0)	1.1	2.6	3.7
Total operating (expense)/income	(0.9)	(3.1)	(4.0)	1.1	2.6	3.7
Working capital adjustment	0.7	0.8	1.5	1.5	1.9	3.4

Notes to the current cost accounts (continued)

At 31 March 2011

3. Current cost operating costs

For the year ended 31 March 2011:

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

Notes to the current cost accounts (continued)

At 31 March 2011

3. Current cost operating costs (continued)

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

Notes to the current cost accounts (continued)

At 31 March 2011

3. Current cost operating costs (continued)

For the year ended 31 March 2010:

Service analysis	Water supply			Sewerage service				
	Resources and treatment £m	Distribution £m	Water supply subtotal £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewerage service subtotal £m	Total appointed business £m
Direct costs								
Employment costs	10.3	9.1	19.4	6.2	10.3	8.3	24.8	44.2
Power	13.3	11.5	24.8	3.1	20.2	7.5	30.8	55.6
Hired and contracted services	3.6	17.8	21.4	9.3	3.9	10.8	24.0	45.4
Materials and consumables	11.5	0.5	12.0	1.2	5.9	4.4	11.5	23.5
Service charges	16.2	-	16.2	2.2	4.6	-	6.8	23.0
Bulk supply imports	1.3	-	1.3	-	-	-	-	1.3
Other direct costs	0.7	1.2	1.9	0.2	0.1	-	0.3	2.2
Total direct costs	56.9	40.1	97.0	22.2	45.0	31.0	98.2	195.2
General and support expenditure	22.2	20.2	42.4	8.0	29.9	18.7	56.6	99.0
Total functional expenditure	79.1	60.3	139.4	30.2	74.9	49.7	154.8	294.2
Business activities								
Customer services			28.4				28.6	57.0
Scientific services			5.8				4.1	9.9
Other business activities			3.5				3.5	7.0
Total business activities			37.7				36.2	73.9
Local authority rates			40.4				12.4	52.8
Doubtful debts			28.6				37.3	65.9
Exceptional items			(30.2)				(30.6)	(60.8)
Total operating expenditure less third party services			215.9				210.1	426.0
Third party services - operating expenditure			10.8				-	10.8
Total operating expenditure			226.7				210.1	436.8
Capital maintenance								
Infrastructure renewals charge	13.1	54.5	67.6	41.3	-	0.2	41.5	109.1
Current cost depreciation								
- service activities	73.4	65.2	138.6	31.0	122.7	47.6	201.3	339.9
- business activities			2.6				3.2	5.8
Amortisation of grants			(4.9)				(3.4)	(8.3)
Capital maintenance excluding third party services			203.9				242.6	446.5
Third party services								
- current cost depreciation			2.4				-	2.4
Total capital maintenance			206.3				242.6	448.9
Total operating costs			433.0				452.7	885.7
CCA (MEA) values:								
Service activities	7,353.0	9,392.2	16,745.2	32,924.8	2,676.5	642.4	36,243.7	52,988.9
Business activities			14.6				17.7	32.3
			16,759.8				36,261.4	53,021.2
Services for the third parties			52.2				-	52.2
Total CCA (MEA) values			16,812.0				36,261.4	53,073.4

Notes to the current cost accounts (continued)

At 31 March 2011

3. Current cost operating costs (continued)

The depreciation charge of £4.0 million on IT systems owned by United Utilities Water PLC, but recharged to other United Utilities companies, has been classified as operating expenditure in accordance with RAG 4.03.

4. Other income

	2011	2010
	£m	£m
Rents receivable	1.0	1.0

5. Current cost analysis of fixed assets by asset type as at 31 March 2011

Total services:

	Specialised operational assets	Non-specialised operational properties	Infra-structure assets	Other tangible assets	Total
	£m	£m	£m	£m	£m
Gross replacement cost					
At 1 April 2010	11,348.9	223.7	47,136.4	399.7	59,108.7
Reclassification adjustment	1.2	(1.2)	1.1	(2.3)	(1.2)
RPI adjustment	604.5	11.8	2,520.2	20.2	3,156.7
Disposals	(41.3)	(3.0)	-	(22.9)	(67.2)
Additions	260.8	8.4	230.6	39.5	539.3
At 31 March 2011	12,174.1	239.7	49,888.3	434.2	62,736.3
Depreciation					
At 1 April 2010	5,717.8	57.6	-	259.9	6,035.3
Reclassification adjustment	3.5	-	-	(4.4)	(0.9)
RPI adjustment	303.9	3.0	-	13.0	319.9
Disposals	(34.0)	(2.6)	-	(17.0)	(53.6)
Charge for the year	347.6	5.1	-	45.4	398.1
At 31 March 2011	6,338.8	63.1	-	296.9	6,698.8
Net book value					
At 31 March 2011	5,835.3	176.6	49,888.3	137.3	56,037.5
At 31 March 2010	5,631.1	166.1	47,136.4	139.8	53,073.4

Notes to the current cost accounts (continued)

At 31 March 2011

5. Current cost analysis of fixed assets by asset type as at 31 March 2011 (continued)

Water services:

	Specialised operational assets £m	Non-specialised operational properties £m	Infra-structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2010	4,486.4	176.4	14,400.1	187.3	19,250.2
Reclassification adjustment	(24.9)	(0.3)	5.1	(5.6)	(25.7)
RPI adjustment	239.0	9.4	769.9	9.5	1,027.8
Disposals	(16.7)	(1.2)	-	(9.7)	(27.6)
Additions	59.5	5.0	84.9	15.1	164.5
At 31 March 2011	4,743.3	189.3	15,260.0	196.6	20,389.2
Depreciation					
At 1 April 2010	2,281.9	39.4	-	116.9	2,438.2
Reclassification adjustment	(0.1)	-	-	(3.9)	(4.0)
RPI adjustment	121.2	2.1	-	5.9	129.2
Disposals	(14.8)	(0.8)	-	(7.0)	(22.6)
Charge for the year	143.5	3.3	-	21.2	168.0
At 31 March 2011	2,531.7	44.0	-	133.1	2,708.8
Net book value					
At 31 March 2011	2,211.6	145.3	15,260.0	63.5	17,680.4
At 31 March 2010	2,204.5	137.0	14,400.1	70.4	16,812.0

Notes to the current cost accounts (continued)

At 31 March 2011

5. Current cost analysis of fixed assets by asset type as at 31 March 2011 (continued)

Sewerage services:

	Specialised operational assets £m	Non-specialised operational properties £m	Infra-structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2010	6,862.5	47.3	32,736.3	212.4	39,858.5
Reclassification adjustment	26.1	(0.9)	(4.0)	3.3	24.5
RPI adjustment	365.5	2.4	1,750.3	10.7	2,128.9
Disposals	(24.6)	(1.8)	-	(13.2)	(39.6)
Additions	201.3	3.4	145.7	24.4	374.8
At 31 March 2011	7,430.8	50.4	34,628.3	237.6	42,347.1
Depreciation					
At 1 April 2010	3,435.9	18.2	-	143.0	3,597.1
Reclassification adjustment	3.6	-	-	(0.5)	3.1
RPI adjustment	182.7	0.9	-	7.1	190.7
Disposals	(19.2)	(1.8)	-	(10.0)	(31.0)
Charge for the year	204.1	1.8	-	24.2	230.1
At 31 March 2011	3,807.1	19.1	-	163.8	3,990.0
Net book value					
At 31 March 2011	3,623.7	31.3	34,628.3	73.8	38,357.1
At 31 March 2010	3,426.6	29.1	32,736.3	69.4	36,261.4

Notes to the current cost accounts (continued)

At 31 March 2011

6. Regulatory capital value (RCV)

	£m
Closing RCV at 31 March 2010	7,686.1
Price Review opening adjustments	
Logging up/down shortfalls	(166.3)
Change in the notified index	159.0
Land sales	(8.4)
Other adjustments	4.9
Opening RCV at 1 April 2010 in March 2010 prices	7,675.3
RCV inflation adjustment	410.4
Opening RCV at 1 April 2010 in March 2011 prices	8,085.7
Capital expenditure (excluding infrastructure renewals expenditure)	503.4
Infrastructure renewals expenditure	175.9
Infrastructure renewals charge	(147.1)
Grants and contributions	(13.8)
Current cost depreciation	(406.2)
AMP 4 outperformance of regulatory assumptions	(18.0)
Closing RCV at 31 March 2011	8,179.9
Average RCV (2010/11 year average prices)	7,922.1

The figures in this table are consistent with those published by Ofwat in their letter RD 04/10 (inflated to 2010/11 prices) and therefore do not agree with other actual values reflected in the company's regulatory financial statements. The differences from actual values do not affect price limits in the 2010-15 price review period. All costs have been indexed to March 2011 (RPI – 232.5) prices, except for the average RCV, which is shown at year average prices (RPI – 226.5), in accordance with Ofwat's regulatory accounting guidelines.

Notes to the current cost accounts (continued)

At 31 March 2011

7. Working capital

	2011 £m	2010 £m
Stocks	4.6	3.7
Trade debtors (see below)	186.2	169.3
Measured income accrual	112.4	118.1
Prepayments and other debtors	11.7	13.6
Trade creditors	(58.7)	(47.6)
Deferred income – customer advance receipts	(120.8)	(128.4)
Short-term capital creditors	(133.8)	(107.5)
Accruals and other creditors	(57.9)	(49.9)
Total working capital	(56.3)	(28.7)

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

	2011 £m	2010 £m
Measured household	32.6	29.7
Unmeasured household	94.1	83.2
Measured non-household	37.9	40.5
Unmeasured non-household	11.0	11.8
Other	10.6	4.1
Trade debtors	186.2	169.3

8. Movement on current cost reserve

	2011 £m	2010 £m
At 1 April	46,077.6	39,346.8
AMP adjustment	-	4,633.1
RPI adjustments:		
Fixed assets	2,836.9	2,254.3
Working capital	(1.5)	(3.4)
Financing	(167.3)	(135.2)
Grants and third party contributions	(24.9)	(18.0)
At 31 March	48,720.8	46,077.6

Notes to the current cost accounts (continued)

At 31 March 2011

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

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

Borrowings and sums lent

The following loans from associated companies existed at 31 March 2011:

	£m	Interest rate	Repayment date
United Utilities PLC: $400.0 million bond	264.3	6.875%	August 2028
North West Water LLC: £205.5 million loan	205.5	0.745%+LIBOR	July 2034
United Utilities PLC: Loan facility of £450.0 million	224.7	0.05%+LIBOR	On at least 18 months notice
United Utilities PLC: overdraft facility	23.3	0.5%+LIBOR	On demand
United Utilities North West PLC: preference shares	130.0	7.0%	October 2099

The following loans to associated companies existed at 31 March 2011:

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

Financial instruments

The following financial instruments with associated companies existed at 31 March 2011:

	Fair value £m	Interest rate payable £m	Interest rate receivable £m	Maturity date £m
United Utilities PLC - £400m interest rate swap	12.8	1.84%	LIBOR	March 2015

Dividends paid to associated undertakings

During the year, interim dividends payable to United Utilities North West PLC totalled £262.2 million (2010: £231.2 million). No final dividend has been recommended for 2010/11 (2010: £nil).

Transfer of assets by or to the appointee

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

Notes to the current cost accounts (continued)

At 31 March 2011

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

Supply of services

Services supplied to the company by associated companies:

Nature of transaction	Company	Terms of supply	2011 Total value of services £m
Support services	United Utilities PLC	Recharge of costs *	53.8

* The support services represent the recharging of costs incurred centrally on behalf of group companies. This includes services provided by the finance and audit, chief information office, HR and health, safety, risk and security, general counsel, communications, insurance and executive departments. Each of these departments provide support to UUW's overall activities. For the 2010/11 financial year, costs have been allocated to UUW based on a Cross Application Timesheet System (CATS) which is divided into three sections: direct business allocations, cross business activities and other activities. The three sections are reviewed annually by the budget managers in each area to check that it includes all areas and activities on which an individual member of staff might work.

As a result of the restructuring of the group, the vast majority of the group's employees now work directly and wholly for the regulated business and UUW is the main business activity for the group. For the 2011/12 financial year, the CATS allocation process discussed above will be replaced by a new allocation process. Employee costs will be allocated to non-regulated activities based on activity identified by regular discussion meetings with heads of department or budget holders. This is considered by directors to be an appropriate solution which will provide reliable and accurate information suited to the shape of the ongoing group.

Services supplied by the company to associated companies:

Nature of transaction	Company	Terms of supply	2011 Total value of services £m
Vertex exit cost	United Utilities PLC	Recharge of costs	5.3
Accommodation	United Utilities PLC	Recharge of costs	3.5
Use of system	United Utilities PLC	Recharge of costs	1.9
Salary and severance recharges	United Utilities PLC	Recharge of costs	1.2
Vehicles maintenance	United Utilities PLC	Recharge of costs	0.3
IT costs	United Utilities PLC	Recharge of costs	0.3
Miscellaneous	United Utilities PLC	Recharge of costs	0.3

Notes to the current cost accounts (continued)

At 31 March 2011

10. Interest rate risk profile

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

	Fixed rate	Floating rate	Index-linked	2010 Total
	£m	£m	£m	£m
Maturity profile				
Due within one year	0.2	162.0	-	162.2
Due between one and two years	0.3	50.0	-	50.3
Due between two and five years	21.7	150.0	-	171.7
Due between five and 20 years	2,120.5	35.3	617.8	2,773.6
Due after more than 20 years	224.5	205.5	1,444.9	1,874.9
Borrowings (excluding preference shares)	2,367.2	602.8	2,062.7	5,032.7
Preference share capital				130.0
Total borrowings				5,162.7
Bank overdraft				5.1
Cash at bank and in hand				(0.3)
Short-term deposits (intercompany loans)				(40.0)
Net debt excluding derivatives				5,127.5

Notes to the current cost accounts (continued)

At 31 March 2011

11. Differences between historical cost regulatory accounts and statutory accounts

	Statutory (UK GAAP) £m	Regulatory Total business £m	Difference £m	Explanation of differences
Profit and loss account				
Operating profit including other income	587.8	591.5	3.7	During 2010/11, £11.7 million (2010: £24.2 million) of expenditure relating to aqueduct security of supply work and £nil (2010: £12.1 million) of expenditure relating to the DG5 flooding programme has been capitalised in the statutory accounts based on the company's interpretation of FRS 15 'Tangible Fixed Assets' and the company has used a five-year period to calculate the infrastructure renewals charge. In the regulatory accounts, expenditure on aqueduct security of supply work and the DG5 flooding programme has been classified as infrastructure renewals expenditure and a 15 year period has been used to calculate the infrastructure renewals charge, based upon the company's interpretation of RAG 2.03. These two items have reduced the infrastructure renewals charge in the regulatory accounts by £1.2 million (2010: £5.3 million). A debit adjustment of £0.8 million (2010: credit of £3.7 million) has also been made to the deferred taxation charge as a result of this treatment. In addition, the company has not recognised revenue in the statutory accounts where it does not consider it probable that it will receive payment. In the regulatory accounts revenue is recognised in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name. Adjustment to turnover net of bad debt charge, being a net credit of £2.5 million (2010: £0.9 million) has been recorded. A debit adjustment of £1.1 million (2010: £0.2 million) has been made to the current taxation charge as a result of this treatment.
Profit before tax	333.8	337.5	3.7	
Tax	(54.2)	(56.1)	(1.9)	

Notes to the current cost accounts (continued)

At 31 March 2011

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

	Statutory (UK GAAP) £m	Regulatory Total business £m	Difference £m	Explanation of differences
Balance sheet				
Tangible fixed assets (net book value)	8,051.8	7,985.2	(66.6)	In the preparation of the statutory accounts, the company has followed industry practice and applied the infrastructure renewals accounting basis as set out in FRS 15 'Tangible Fixed Assets'. An infrastructure renewals accrual of £24.6 million (2010: £13.5 million) is within fixed assets in the statutory accounts. However, for the purposes of the regulatory accounts, Ofwat has requested that FRS 15 'Tangible Fixed Assets' is not applied for infrastructure renewals accounting. The regulatory accounts infrastructure renewals prepayment of £7.2 million (2010: £5.4 million) is therefore shown within current assets (2010: current assets) in the regulatory accounts. The difference between the infrastructure renewals accrual in the statutory accounts and infrastructure renewals prepayments in the regulatory accounts arises from the differences in interpretation of infrastructure renewals accounting policies as explained in the profit and loss on page 106. The statutory accounts fixed assets include the cumulative value of the aqueduct security of supply work and the DG5 flooding programme capitalisation of £91.2 million (2010: £79.6 million).
Short-term deposits	1.6	41.6	40.0	Short-term deposits in the regulatory balance sheet include loans to group companies. These balances are classified in debtors falling due within one year within the statutory balance sheet.
Creditors: amounts falling due within one year	(604.2)	(524.9)	79.3	In line with the requirements of RAG 3.06, the £130.0 million (2010: £130.0 million) preference shares have been separately disclosed on the face of the regulatory balance sheet. As these shares may be redeemed by not less than 30 days' written notice served by the company or the shareholder, they have been classified within the borrowings creditor falling due within one year within the statutory accounts. In the regulatory accounts deferred grants are classified within provisions for liabilities and charges in line with RAG 3.06. However, these amounts are classified for statutory accounts within creditors due within one year (£6.4 million) and creditors falling due after one year (£78.0 million). An amount of £55.7 million (2010: £58.6 million) relating to measured customers who have credit balances arising from a direct debit plan existed at 31 March 2011. In line with the reporting requirements of June Return, these balances have been classified within creditors falling due within one year in the regulatory accounts. However, these balances are classified in debtors falling due within one year within the statutory accounts. Also as detailed above, a debit adjustment of £1.4 million (2010: £0.3 million) has been made to the current tax liability as a result of recognition of revenue in respect of all recorded occupied properties regardless of any previous payment history or whether the company has the occupier's name.

Notes to the current cost accounts (continued)

At 31 March 2011

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

	Statutory (UK GAAP) £m	Regulatory Total business £m	Difference £m	Explanation of differences
Creditors: amounts falling due after one year	(5,362.4)	(5,284.4)	78.0	As detailed above, deferred grants are classified within provisions for liabilities and charges in the regulatory accounts in line with RAG 3.06 but within creditors falling due after one year in the statutory accounts.
Provisions for liabilities and charges (including pension liability)	(444.5)	(517.3)	(72.8)	Provisions are £84.4 million higher in the regulatory accounts due to the inclusion of deferred grants as detailed above (2010: £86.9 million). This increase is partially offset by a lower deferred tax provision of £11.6 million (2010: £12.7 million) in the regulatory accounts due to the impact of the difference in the infrastructure renewals policy and capitalisation of the aqueduct security of supply work and the DG5 flooding programme between the statutory and regulatory accounts.
Preference share capital	-	(130.0)	(130.0)	In line with the requirements of RAG 3.06, the £130.0 million (2010: £130.0 million) preference shares have been separately disclosed on the face of the regulatory balance sheet. As these shares may be redeemed by not less than 30 days' written notice served by the company or the shareholder, they have been classified within the borrowings creditor falling due within one year within the statutory accounts.

12. Statement of directors' remuneration and standards of performance

During the year ended 31 March 2011 remuneration has been paid by the company to the directors as a result of arrangements linking directors' remuneration to levels of performance against service standards in connection with activities subject to price regulation.

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

- Executive directors of United Utilities Water PLC (UUW PLC);
- Executive directors of United Utilities Group PLC (UUG PLC) and/or United Utilities PLC (UU PLC) who are also executive directors of UUW PLC; and
- Non-executive directors of UUW PLC.

At the start of each financial year or the date of appointment, whichever is later, a bonus scheme is implemented for all employees including directors. Through the United Utilities bonus scheme, the UUW PLC directors receive remuneration linked to water service standards in order to provide an incentive for them to deliver improvements in those standards. The bonus scheme has a financial gateway based on underlying operating profit which must be passed before any bonus is payable.

Notes to the current cost accounts (continued)

At 31 March 2011

12. Statement of directors' remuneration and standards of performance (continued)

As part of the scheme, performance was assessed against the following water service measures which are regularly monitored on a UUW scorecard:

Scorecard measure	Achievement in 2010/11
Reduction in accident frequency rates	Actual achieved exceeded target for one measure but fell short of target for second measure
Improvement in customer satisfaction measures	Actual achieved exceeded target
Achieve regulatory outputs targets	Actual achieved partially met target
Achieve serviceability target	Actual achieved exceeded target
Achieve capital efficiencies target	Actual achieved fell short of target
Achieve operating cost target	Actual achieved exceeded target
Achieve operating cash flow target	Actual achieved exceeded target
Achieve corporate responsibility targets	Actual achieved exceeded target

In arriving at a bonus outcome, standards of performance are assessed by the United Utilities Group PLC Remuneration Committee to ascertain whether targets were achieved. In addition, the directors also considered relevant reports from Ofwat in assessing the achievement of standards of performance. In 2010/11 the majority of the UUW scorecard targets were achieved. The bonus in respect of certain measures is payable in full on achievement of the target whilst for other measures there is a threshold target which triggers a partial bonus payment with a sliding scale providing for achievement of up to 100% of the relevant element of bonus. The remainder of the directors' salary is based on a competitive benchmark.

Details of the bonus payments made for the UUW PLC directors in respect of these measures for the year ended 31 March 2011 are as follows:

Director	Bonus re: UUW scorecard targets
M Carmedy (1)	£26,817
SR Fraser	£34,577
PN Green (2)	£240,514
JR Houlden (2)	£59,240
SL Mogford (2)	£46,062
GL Sims	£16,446
TP Weller (2)	£18,842
MR Wright	£34,599

(1) UU PLC director is remunerated by the intermediate parent company and costs are recharged to UUW PLC.

(2) UUG PLC and UU PLC directors are remunerated by the intermediate parent company and costs are recharged to UUW PLC.

The UUG PLC directors participate in the group bonus scheme as documented in the UUG annual report. As per the requirements of RAG 3.06, the bonuses shown here represent the element of bonus they received, under that group bonus scheme, which related to UUW scorecard targets only. They receive no bonus directly from UUW PLC in respect of water service standards.

For the forthcoming year, the UUG PLC incentive arrangements will continue to reflect the importance of achieving service standards. Performance will again be assessed against key measures including leakage, bacteriological compliance and Service Incentive Mechanism (SIM) scores, which are routinely used by Ofwat to assess standards of company performance.

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

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