Independent auditor's report to the members of United Utilities Group PLC only

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of United Utilities Group PLC for the year ended 31 March 2017 set out on pages 124 to 171. In our opinion:

› the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2017 and of the group's profit for the year then ended;

› the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);

› the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and

› the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.

Overview

Materiality group financial statements as a whole	£19.5m (2016: £20.0m), 4.7% (2016: 4.9%) of normalised group profit before tax	
Coverage	100% (2016: 100%) of normalised group profit before tax	
Risks of material misstatement		**vs 2016**
Recurring risks	Revenue recognition and provision for customer debts	◀ ▶
	Capital expenditure	◀ ▶
	Retirement benefit surplus	◀ ▶

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as set out below. We no longer consider derivative financial instrument valuations to be a significant risk of material misstatement on the basis that the valuations performed are mechanistic in nature and, although they are cumulatively a large balance, the risk of an error within the balance is relatively low.

	The risk	Our response
Revenue recognition and provision for customer debts Revenue: £1,704.0 million (2016: £1,730.0 million) Provision for customer debts: £85.4 million (2016: £94.4 million) *Refer to page 79 (Audit Committee report), pages 131 and 165 (accounting policy), and pages 134 and 143 (financial disclosures).*	**Subjective estimation:** A proportion of the group's customers do not, or cannot, pay their bills, which results in the need for provisions to be made for non-payment of the customer balance. Due to the level of judgement and complexity of the calculation, which could lead to revenue and provision for customer debt being misstated, this is considered a key audit risk. Significant judgement is required when recognising revenue for services that are billed that relate to properties where either the occupier cannot be identified or where a past history of non-payment of bills exists and therefore there is uncertainty over the probability of these bills being settled. Further, an estimate is required of revenue for the value of water supplied to metered customers between the last meter reading and the period end.	Our procedures included: **Accounting analysis** – comparison of policy with relevant accounting standards and industry practice, including the policy of not recognising revenue where it is not probable that cash will be received. Then through observation of processes assessing whether the revenue recognition policies have been applied in practice; **Control observation** – testing the group's controls over revenue recognition and provision for customer debts, including reconciliations between sales and cash receipts systems and the general ledger; **Methodology choice** – assessing the appropriateness of the customer debt provisioning based on historical cash collections, credits, re-bills and write-off information; **Tests of details** – assessing the assumptions used to calculate the metered accrued income by considering whether inputs to the calculation have been derived appropriately and recalculating the accrued income with the support of our own modelling speciaists; and **Assessing transparency** – assessing the adequacy of the group's disclosures of its revenue recognition and customer debt provisioning policies, including the estimation uncertainty involved in recording revenue and the bad debt provision.

KPMG

	The risk	Our response
Capital expenditure £717.9 million (2016: £665.8 million) Refer to page 79 (Audit Committee report), pages 131 to 132 and 166 (accounting policy), and page 140 (financial disclosures).	**Accounting treatment:** The group has a substantial capital programme which has been agreed with the Water Services Regulation Authority (Ofwat) and therefore incurs significant annual expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. The determination of project costs as capital or operating expenditure is inherently judgemental as there is a need to distinguish between enhancement and maintenance works. Costs capitalised include an allocation of overhead costs, relating to the proportion of time spent by support function staff, which is also inherently judgemental.	Our procedures included: **Accounting analysis** – assessing the group's capitalisation policy for compliance with relevant accounting standards; **Control observation** – testing controls over the application of the policy in the period including assessment of project business case submissions and attending capital approval meetings to observe the judgements made and evaluating the documented conclusions; **Tests of details** – critically assessing the costs capitalised for a sample of projects against the capitalisation policy; **Tests of details** – identify and assess the impact of in-year changes to capitalisation rates and for all existing projects, as once set they are typically unchanged period to period; **Historical comparisons** – critically assess the proportion of overhead costs by business area which are capitalised using historical comparisons and expected changes based on corroborated enquiry and our sector knowledge; and **Assessing transparency** – assessing the adequacy of the group's disclosures of its capitalisation policy and other related disclosures.
Retirement benefit surplus £247.5 million (2016: £275.2 million) Refer to page 79 (Audit Committee report), pages 132 and 168 (accounting policy), and pages 145 and 159 to 163 (financial disclosures).	**Subjective estimation:** Significant estimates are made in valuing the group's retirement benefit obligation. Small changes in assumptions and estimates used to value the group's pension obligation would have a significant effect on the group's financial position.	Our procedures included: **Benchmarking assumptions** – challenging the key assumptions supporting the group's retirement benefit obligations valuation with input from our own actuarial specialists, including comparing the discount rate, inflation rate, salary, pension increase rates and life expectancy assumptions used against externally derived data; and **Assessing transparency** – assessing the group's disclosure in respect of the sensitivity of the surplus to changes in the key assumptions.

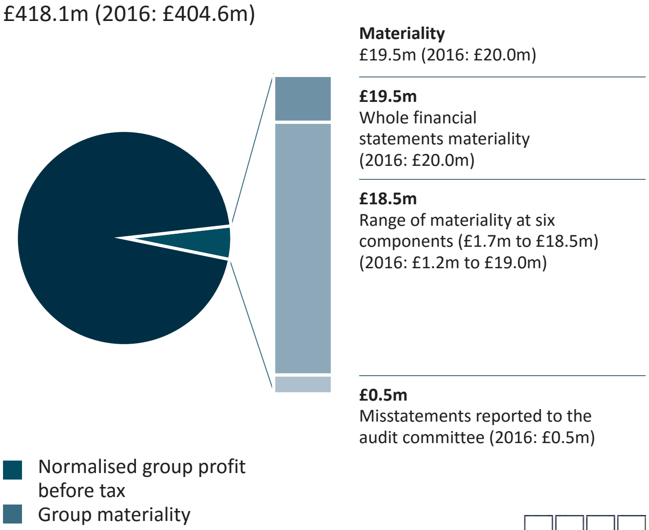
3. Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £19.5 million (2016: £20.0 million), determined with reference to a benchmark of group profit before tax, normalised to exclude net fair value losses on debt and derivative instruments (see note 5). Materiality represents 4.7 per cent (2016: 4.9 per cent) of normalised group profit before tax. Specific audit procedures have been performed over items excluded from the normalised profit before tax.

We report to the audit committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2016: £0.5 million), in addition to other identified misstatements that warrant reporting on qualitative grounds.

Normalised group profit before tax

£418.1m (2016: £404.6m)



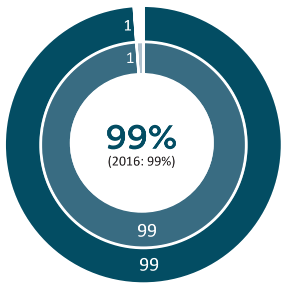
Independent auditor’s report to the members of United Utilities Group PLC only

Of the group’s six (2016: six) reporting components, we subjected six (2016: five) to audit, of which the most significant is United Utilities Water Limited, which makes up the vast majority of the assets, liabilities, income and expense of the group. These components covered 99 per cent of group revenue (2016: 99 per cent), 100 per cent of group profit before tax (2016: 100 per cent), 100 per cent of group normalised profit before tax (2016: 100 per cent), and 97 per cent of group total assets (2016: 100 per cent).

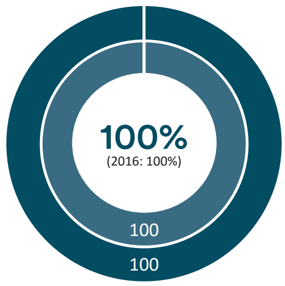
The group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The group team approved the component materialities, which ranged from £1.7 million to £18.5 million (2016: £1.2 million to £19.0 million), having regard to the mix of size and risk profile of the group across the components. The work on one of the six components (2016: none of the six components) was performed by component auditors and the rest by the group team. The group team performed procedures on the items excluded from normalised group profit before tax.

The group team visited the component location in Stoke. Telephone conference meetings were also held with these component auditors. At these meetings the findings reported to the group team were discussed in more details and any further work required by the group team was then performed by the component auditor.

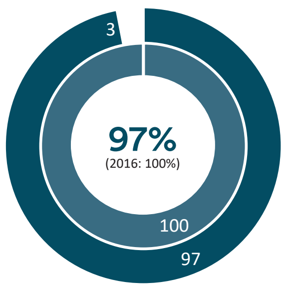
Group revenue



Group normalised profit before tax



Group total assets



- Full scope for group audit purposes 2017
- Residual components 2017
- Full scope for group audit purposes 2016
- Residual components 2016

4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

› the part of the Directors’ Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;

› the information given in the Strategic report and the Directors’ report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

› we have not identified material misstatements in these reports; and

› in our opinion those reports have been prepared in accordance with the Companies Act 2006.

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

› the directors’ statement of long-term viability on page 73, concerning the principal risks, their management, and, based on that, the directors’ assessment and expectations of the group’s continuing in operation over the five years to March 2022; or

› the disclosures in the accounting policies section concerning the use of the going concern basis of accounting.

6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

› we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy; or

› the audit committee section of the Corporate Governance report does not appropriately address matters communicated by us to the audit committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

› adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or

› the parent company financial statements and the part of the Directors' Remuneration report to be audited are not in agreement with the accounting records and returns; or

› certain disclosures of directors' remuneration specified by law are not made; or

› we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

› the directors' statements, set out on page 73 and 131, in relation to going concern and longer-term viability; and

› the part of the Corporate Governance Statement on page 57 relating to the company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Statement of directors' responsibilities set out on page 117, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

William Meredith (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
St Peter's Square, Manchester, M2 3AE
24 May 2017