Financial oversight responsibilities of the board

4
Audit, risk and internal control

Principle M:
The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.

Our application of principle M is formalised in our non-audit services policy and terms of engagement with the auditor as agreed by the committee. The head of internal audit and risk reports to the committee and to the CFO but only on a functional basis, thereby ensuring a direct line of communication between internal audit and the committee. In accordance with provision 25, an explanation of the independence and effectiveness of the external audit process can be found on pages 149 to 150, and the reappointment of the statutory auditor on page 151. The board considered and was satisfied on the integrity of the financial and narrative statements, as advised by the audit committee in accordance with DTR 7.1.3(5).

Principle N:
The board should present a fair, balanced and understandable assessment of the company's position and prospects.

We have applied principle N, as confirmed by our disclosure against provision 27, which can be found on page 196 and is supported by our disclosure against provision 25 on page 149.

Principle O:
The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Our risk management framework and principal risks are on pages 100 to 107. Further information on the company's internal audit function and controls can be found on pages 154 to 155 and together set out our application of principle O.

Board's responsibility for financial oversight
One of the fundamental roles of the board is to oversee the financial performance of the business. The board is supported in this role by the audit committee whose activities are described on pages 144 to 154. The board reviews the financial performance of the company at every scheduled board meeting, receiving a report from the CFO which provides the board with the up-to-date position of the consolidated financial statements, interpretative analysis and other key performance indicators, metrics and ratios. The board takes into account the review by the audit committee of the financial and narrative statements, and the auditor's views on the key risks and judgements identified and given particular focus in their audit work and set out in their report (see page 200), and the information and explanations provided by management in relation to their key judgements and adjustments to APMs. The board considered the review and assurance process undertaken by management, and considered by the audit committee to support the application of principle N. The board concluded that in the 2020/21 annual report and financial statements it has presented a fair, balanced and understandable assessment of the company's position and prospects, and the board was satisfied on the integrity of the financial and narrative statements. Furthermore, the board approved the accounts and provision of the directors' responsibility statement at its meeting on 26 May 2021, see page 196.

Oversight of financial aspects of ESG
ESG, and behaving responsibly, has been a long-term commitment and part of the board ethos for many years and is embedded in everything we do. It naturally flows through into our approach to the integrity of our financial reporting. Recognising that climate change is a key risk to our provision of water and wastewater services (see page 104), 2020/21 is the second year that we have reported against TCFD. As part of the processes supporting the provision of the 'fair, balanced and understandable' statement, we took into account the existing processes of review and assurance of our TCFD and wider narrative reporting (see above). We intend to further review the assurance processes of ESG matters, particularly those relating to TCFD reporting, ahead of the mandatory reporting requirement which will apply to our 31 March 2022 annual report.

Board's approach to risk management and internal control
The board discharges its responsibility for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives through the risk appetite framework. As a key part of the risk management framework, risk appetite captures the board's desire to take and manage risk relative to the company's obligations, stakeholder interests and the capacity and capability of our key resources.

The board is responsible for ensuring that the company's risk management and internal control systems are effectively managed across the business and that they receive an appropriate level of scrutiny and board time.

The group's risks predominantly reflect those of all regulated water and wastewater companies. These generally relate to the failing of regulatory performance targets or failing to fulfil our obligations in any five-year planning cycle, potentially leading to the imposition of fines and penalties, in addition to reputational damage. Climate change is a risk that underpins our core operations and provision of water and wastewater services to customers (see page 104).

Review of the effectiveness of the risk management and internal control systems
During the year, the board reviewed the effectiveness of the risk management systems and internal control systems, including financial, operational and compliance controls. Taking into account the principal risks and uncertainties set out on pages 100 to 107, the ongoing work of the audit committee in monitoring the risk management and internal control systems (see pages 154 and 155) on behalf of the board, (and to whom the committee provides regular updates), the board:

- is satisfied that it has carried out a robust assessment of the emerging and principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; and
- has reviewed the effectiveness of the risk management and internal control systems, including all material financial, operational and compliance controls (including those relating to the financial reporting process) and no significant failings or weaknesses were identified.

After review, the board concluded that through a combination of the work of the board, the audit committee and the UUW board (which has particular responsibility for operational and compliance controls), the company's risk management and internal controls were indeed effectively monitored throughout the year.

Corporate governance report

Financial oversight responsibilities of the board

The board's review of the effectiveness of risk management and internal control systems took into account the:

- biannual review of significant risks and emerging risks (see pages 104 to 107 and 109);
- assurance (both internal and external) of the most significant business and operational risks of the group;
- review of matters correlating to specific event based operational risks (see page 108);
- outcome of the biannual business unit risk assessment process (see page 154);
- activities and review of the effectiveness of the internal audit function (see page 154);
- opinion provided by internal audit in relation to their work, that 'the governance, risk management and internal control framework was suitably designed and effectively applied within the areas under review';
- self-assessment provided by management confirmed compliance with a range of key internal policies, processes and controls (see page 155);
- review of reports from the group audit and risk board (see page 101);
- oversight of treasury matters, in particular debt financing and interest rate management (see page 125); and
- review of the business risk management framework and management's approach and tolerance towards risk (see page 100).

Going concern and long-term viability

The following section sets out the company's compliance with part of provisions 30 and 31.

The board, following the review by the audit committee, concluded that it was appropriate to adopt the going concern basis of accounting (see page 214). Similarly, in accordance with the principles of the code, the board concluded, following the recommendation from the audit committee, that it was appropriate to provide the long-term viability statement based on an assessment period of seven years. Assurance supporting these statements was provided by the review of: the group's key financial measures and contingent liabilities; the key credit financial ratios; and the group's liquidity and ongoing ability to meet its financial covenants. As part of the assurance process, the board also took into account the principal risks and uncertainties facing the company, and the actions taken to mitigate those risks, and include emerging and more topical risks.

These principal risks and uncertainties are detailed on pages 104 to 107, as are the risk management processes and structures used to monitor and manage them. Biannually, the board receives a report detailing management's assessment of the most significant risks facing the company. The report gives an indication of the level of exposure, subject to the mitigating controls in place, for the risk profile of the group, while also highlighting the reputational and customer service impact. This provides the board with information in two categories: group-wide business risks; and wholesale operational risks. The board also receives information during the year from the treasury committee (to which the board has delegated matters of a treasury nature see page 125) including such matters as liquidity policy, the group's capital funding requirements and interest rate management.

Long-term viability statement

The directors have assessed the viability of the group, taking account of the group's current position, the potential impact of the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions. This assessment has been performed in the context of the group's prospects as considered over the longer term. Based on this viability assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the seven year period to March 2028.

Basis of assessment

This viability statement is based on the fundamental assumption that the current regulatory and statutory framework does not substantively change. The long-term planning detailed on page 48 assesses the group's prospects and establishes its strategy over a 25-year time horizon consistent with its rolling 25-year licence and its published long-term strategy. This provides a framework for the group's strategic planning process, and is key to achieving the group's aim of providing the best service to customers at the lowest sustainable price and in a responsible manner over the longer term, underpinning our business model set out on pages 30 to 46.

In order to achieve this aim and promote the sustainability and resilience of the business, due consideration is given to the management of risks over the long term that could impact on the business model, future performance, credit ratings, solvency and liquidity of the group. Specifically, risks associated with the possible ongoing impact of the COVID-19 pandemic and climate change have been incorporated into the baseline position and factored into the various scenarios modelled as part of the group's assessment. An overview of our risk management approach that supports the group's long-term planning and prospects, together with the principal risks and uncertainties facing the business, can be found on pages 104 to 107.

Within the context of this long-term planning and management of risks, the group's principal business operates within five year regulatory price control cycles. Medium-term planning considers the current price control period, over which there is typically a high degree of certainty, and looks beyond this in order to facilitate smooth transitions between price control periods. This results in the board concluding a recurring period of seven years to be an appropriate period over which to perform a robust assessment of the group's long-term viability.

Viability assessment: resilience of the group

The viability assessment is based upon the group's medium-term business planning process, which sits within the overarching strategic planning process and considers:

- The group's current liquidity position – with £1.3 billion of available liquidity at March 2021 providing a significant buffer to absorb short-term cash flow impacts;
- The group's robust capital solvency and credit rating positions – with a debt to regulatory capital value (RCV) ratio of circa 62 per cent, a robust pension position and current credit ratings of A3/BBB+/A- with Moody's, S&P and Fitch respectively, this provides considerable headroom supporting access to medium-term liquidity where required;
- The group's expected performance, underpinned by its historical track-record; and
- The current regulatory framework within which the group operates – which provides a high degree of cash flow certainty over the regulatory period and the broader regulatory protections outlined below.

The group has a proven track-record of being able to raise new finance in most market conditions, and expects to continue to do so into the future. This is despite the group no longer having access to future EIB funding following the UK's exit from the EU.

From a regulatory perspective, the group benefits from a rolling 25-year licence and a regulatory regime in which regulators – including the economic regulator, Ofwat – are required to have regard to the principles of best regulatory practice. These include that regulation should be carried out in a way that is transparent, accountable, proportionate, consistent and targeted. Ofwat's primary duties provide that it should protect consumers' interests, by promoting effective competition wherever appropriate; secure that the company properly carries out its statutory functions; secure that the company can finance the proper carrying out of these functions – in particular through securing

reasonable returns on capital; and secure that water and wastewater supply systems have long term resilience and that the company takes steps to meet long-term demands for water supplies and wastewater services.

In addition, from an economic perspective, given the market structure of water and wastewater services, threats to the group's viability from risks such as reduced market share, substitution of services and reduced demand are low compared to those faced by many other industries.

Viability assessment: resilience to principal risks facing the business

The directors have assessed the group's viability based on the resilience of the group and its ability to absorb a number of 'severe but reasonable' scenarios, derived from the principal risks facing the group, as set out on pages 104 to 107. The baseline plan against which the viability assessment has been performed incorporates the estimated ongoing impact COVID-19 based on experience to date. This baseline plan is then subject to further stress scenarios and reverse stress testing that takes into account the potential impact of group's principal risks. Such risks include: environmental risks such as the occurrence of extreme weather events and other impacts of climate change, further details of which are included in the group's TCFD disclosures on pages 86 to 99; political and regulatory risks; the risk of critical asset failure; significant cyber security breaches; longer term economic impacts resulting from COVID-19, including unemployment and corporate failures affecting debt collection and lower inflation affecting revenues, financing costs and RCV; and the potential for a restriction to the availability of financing resulting from a capital markets crisis. The UK's withdrawal from the EU and the ending of the transition period has not had a material adverse operational or financial impact on the group to date, and is not considered to represent a significant risk to the group's ongoing viability.

The scenarios considered are underpinned by the group's established risk management processes, taking into account those risks with a greater than 10 per cent (1 in 10) cumulative likelihood of occurrence. The risks associated with COVID-19 are reflected within the baseline position, with further potential downside risks (most notably in relation to bad debt and low inflation) covered by the individual scenarios modelled, and collectively within a combined scenario.

The assessment has considered the impact of these scenarios on the group's business model, future performance, credit ratings, solvency and liquidity over the course of the viability assessment period. This assessment has demonstrated the group's ability to absorb the impact of all severe but reasonable scenarios modelled, without the need to rely on the key mitigating actions detailed below.

As part of the assessment, reverse stress testing of two extreme theoretical scenarios focusing on totex overspend and persisting low inflation have been performed to understand the extent to which the group could further absorb financial stress before it reaches a sub-investment grade credit rating. This reverse stress testing demonstrated that these extreme conditions would have to be significantly outside what would be considered 'severe but reasonable' scenarios before the group's long-term viability would be at risk.

Viability assessment: key mitigating actions

In the event of more extreme but low likelihood scenarios occurring, there are a number of key mitigations available to the group, the effectiveness of which are underpinned by the strength of the group's capital solvency position.

As well as the protections that exist from the regulatory environment within which the group operates, a number of actions are available to mitigate more severe scenarios, which include: the raising of new finance, including hybrid debt; capital programme deferral; reduction in other discretionary totex spend; the close-out of derivative asset positions; the restriction of dividend payments; and access to additional equity.

Governance

The analysis underpinning this assessment has been through a robust internal review process, which has included scrutiny and challenge from the audit committee and board, and has been reviewed by the group's external auditor, KPMG, as part of their normal audit procedures.

Going concern

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

Corporate governance report

Audit committee

The audit committee is responsible for discharging governance responsibilities in respect of audit, risk and internal control, and reports to the board on these matters.

Brian May
Chair of the audit committee

Dear Shareholder

In my report this year I have sought to provide shareholders with an understanding of the work we have done as the audit committee to provide assurance on the integrity of the annual report and financial statements for the year ended 31 March 2021. Much of the work of the committee is necessarily targeted at the regulated activities of UUW, which represent over 98 per cent of group revenues and is a reflection of our commitment to safeguarding the interests of our stakeholders, particularly our shareholders and customers.

The timing of the pandemic has meant that both the 2020 and 2021 year end audits have been conducted under lockdown rules. Working practices of the group's financial reporting team and those of KPMG audit team have been adapted, reflecting the lessons learnt from the 2020 audit which was undertaken in the early stages of the pandemic. In addition, through the last year certain changes to internal controls were necessary, reflecting the move to home working, due to the practical difficulties of obtaining wet signatures as the usual evidence of approval. Changes were implemented by the treasury, commercial and property teams. Such changes, and the effectiveness thereof, were reviewed by, and agreed with, the internal audit team.

Management made a number of changes to its alternative performance measures (APMs) to better enable comparability with other companies, rather than reflect the nuances of the regulatory model. The committee concurred with the changes, and in particular that there should be no adjustments to underlying profit relating to COVID-19 at 31 March 2021, recognising that, for the group, operating in the COVID-19 environment had become business as usual. A guide to APMs can be found on page 82.

The group's purpose is to 'provide great water and more for the North West'. The committee's contribution to achieving the purpose is to ensure that the interests of shareholders and other stakeholders are properly protected by overseeing the group's financial reporting and internal control arrangements. The committee uses its collective expertise, with input from the auditor, to provide challenge to the approach and judgements made by management in the treatment of financial matters and the resulting disclosures within the company's financial statements. Transparency and openness are fundamental to the relationship between management and the committee, something which is reinforced through the cultural framework within which the business operates, with being trustworthy one of our core values.

As articulated in the code, 'the board should present a fair, balanced and understandable assessment of the company's position and prospects'. The board asks the audit committee to advise on whether in fact 'the annual report and accounts, taken as a whole, is fair balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'.

The committee chose to retain KPMG as auditor following the competitive tender process conducted in December 2019, as reported in the 2019/20 report. The primary factor for the committee in retaining the services of KPMG, was that, in the committee's view, it offered a more compelling case for the provision of a high-quality audit than the other candidates participating in the tender. As set out on page 151, the group has tendered and changed the auditor on a number of occasions since the

QUICK FACTS

- Brian May has chaired the committee since July 2013. He is a chartered accountant and is considered by the board to have recent and relevant financial experience, having served as finance director of a FTSE 100 company, from which he retired in February 2020.
- All members of the committee are independent non-executive directors and the board is satisfied that the committee as a whole has competence relevant to the sector. Attendance at audit committee meetings is set out on page 124, and the relevant directors' biographies can be found on pages 112 to 115.
- Other regular attendees at meetings at the invitation of the committee include the CEO, the CFO, the company secretary, the head of audit and risk, the group controller, and representatives from the statutory auditor, KPMG LLP (KPMG). None of these attendees are members of the committee.
- The representatives from KPMG and the head of audit and risk each have time with the committee and the company secretary to raise freely any concerns they may have without management being present.
- The committee is authorised to seek outside legal or other independent professional advice as it sees fit, but has not done so during the year.

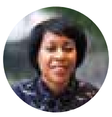
Quick link

Terms of reference – unitedutilities.com/corporate-governance

Audit committee members

Brian May (chair)

Stephen Carter



Paulette Rowe

Doug Webb

MAIN RESPONSIBILITIES

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

group was originally formed in 1989. 2020/21 has been KPMG's tenth year in office. Ian Griffiths was appointed as the new audit engagement partner for the 2020/21 audit.

As part of the committee's review of the performance and recommendation on reappointment of auditor, it took into account the annual review published in July 2020 by the Financial Reporting Council's (FRC's) Audit Quality Review Team. The findings, based on a sample of 88 audits from across the seven largest UK firms, reported that 'firms are still not consistently achieving the necessary level of audit quality'. The committee challenged KPMG on the FRC's findings and also reviewed whether the quality improvement proposals outlined to the committee had indeed been implemented in the 2019/20 audit. Following the committee's review of the effectiveness of the 2019/20 audit process, additional proposals were put forward as part of the 2020/21 audit scope (see page 149).

Transparency and openness are fundamental to the relationship between management and the committee, something which is reinforced through the cultural framework within which the business operates

Auditor independence is a key principle, and contributing factor to audit quality. It is reviewed as part of the audit scope and re-examined prior to the accounts being approved and signed by the board. The auditor must be independent of the company. It is the committee's responsibility to ensure that the three-way relationship between the committee, the auditor and the company's management is appropriate and there is no undue influence by any of the parties on the other, thereby ensuring the integrity of the audit process and the annual report and financial statements. Independence is a key focus for the auditor, whose staff must comply with their firm's own ethics and independence criteria which must be consistent with the FRC's Revised Ethical Standard (2019). Information on how the committee assesses the independence of the auditor can be found on page 150. The statutory auditor presents its audit findings to the shareholders as the owners of the business (see page 200).

The committee has responsibility for ensuring that the group's policy on non-audit services reflects the FRC's Revised Ethical Standard (2019) whereby the only non-audit services that a statutory auditor is permitted to provide to a public interest entity are those required by law or regulation, loan covenant reporting, other assurance services closely linked to the audit and/or reporting accountant services. Assurance on this matter is provided by the auditor.

In summary, the committee concluded that the statutory audit process and services provided by KPMG for 2019/20 were satisfactory and effective.

We continue to be committed to providing meaningful disclosure of the committee's activities and ensuring the committee's agenda is kept abreast of relevant developments. The committee will await the outcome of the BEIS consultation on 'Restoring trust in audit and corporate governance' and we expect to contribute to the consultation process. We are fully committed to ensuring that the group's audit and governance arrangements reflect best practice and address any new requirements within the expected time frames.

Following review of our 31 March 2020 accounts by the FRC (see page 152), we have enhanced a number of disclosures in our financial statements.

There is an element of overlap between our statutory and regulatory reporting. Engaging the same auditor improves efficiency. It contributes to the integrity of the narrative reporting statements, with the auditor reviewing them in accordance with ISA720 (see page 149). Furthermore, the committee has been provided with greater visibility of the assurance of the non-financial information in the annual report.

The details of the external evaluation of the committee's performance can be found on page 135.

I would like to extend my thanks to my committee colleagues for their work and support during my last year as chair of the committee. Doug Webb will take over the role at the conclusion of the annual general meeting in July 2021. Doug joined the committee on his appointment in September 2020, and at the beginning of the 2021 financial reporting cycle. He has considerable recent and relevant financial experience both as a former FTSE 100 CFO and through his other non-executive appointments. The skills matrix on page 133 summarises the experience of the committee's members.

This report was approved by the committee at its meeting held on 19 May 2021.

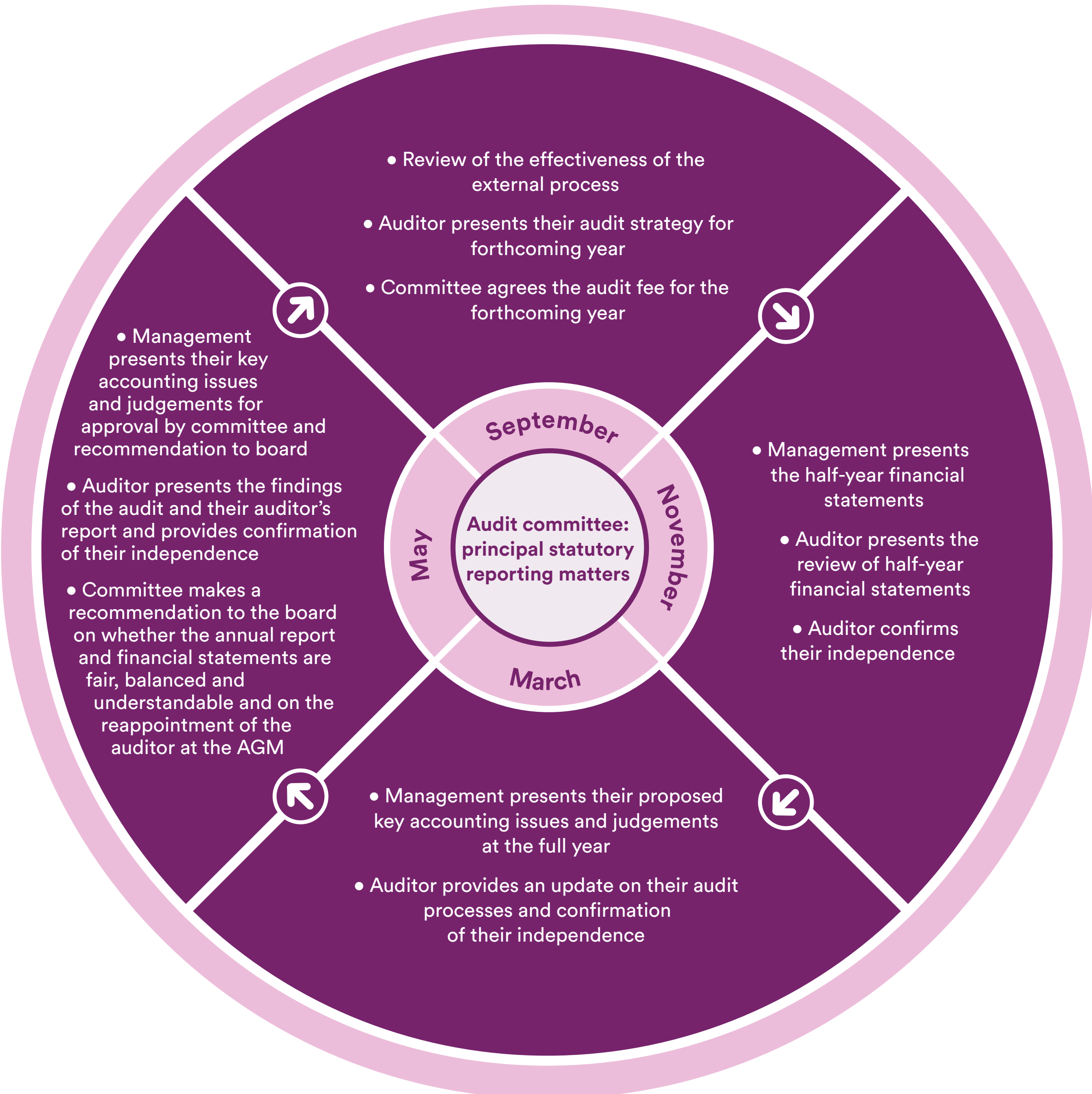
Brian May
Chairman of the audit committee

Corporate governance report
Audit committee

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

The committee has an extensive agenda of items of business focusing on the audit, assurance and risk processes within the business which it deals with in conjunction with senior management, the auditor, the internal audit function and the financial reporting team. The committee's role is to ensure that management's disclosures reflect the supporting detail provided to the committee or challenge them to explain and justify their interpretation and, if necessary, re-present the information. The committee reports its findings and makes recommendations to the board accordingly. The committee is supported in this role by using the expertise of the statutory auditor, who, in the course of the audit, considers whether the financial statements have been prepared in accordance with IFRS and whether adequate accounting records have been kept. In doing so it ensures that high standards of financial governance, in line with the regulatory framework as well as market practice for audit committees going forward, are maintained. Furthermore, the company's own internal audit team contributes to the assurance process by reviewing compliance with internal processes. The committee's financial reporting cycle, which starts each year in September, is shown below. There were four meetings of the committee held during the year. Items of business considered by the committee are set out on pages 147 to 148.

Audit committee financial reporting cycle



Actions	Outcomes	Cross reference
Annual and half-year reporting		
Reviewed and discussed the reports from the financial reporting team on the financial statements, considered management's significant accounting judgements, and the policies being applied both at the full and half year and how the statutory audit contributed to the integrity of the year end financial reporting.	The committee challenged management on a number of its judgements and sought detailed explanations of its interpretation. The committee was satisfied with the explanations provided by management. Recommendations were made to the board, supporting the approval of the half and full-year accounts and financial statements.	See pages 152 to 153
Reviewed the regulatory reporting process relating to the annual performance report for UUW as required to be submitted to Ofwat and noted the differences between the regulatory and statutory accounts.	Contribution to the assurance of the regulatory reporting to the UUW board.	–
Assessed management's revision of APMs to better enable comparability with other companies rather than reflecting the nuances of the regulatory model and adjustments to underlying profit.	Concurred with management's revised approach, and the recognition that, for the group, operational and financial performance in the COVID-19 environment had become business as usual.	See page 82
Reviewed the proposed audit strategy for the 2020/21 statutory audit, including the level of materiality applied by KPMG, audit reports from KPMG on the financial statements and the areas of particular focus for the 2020/21 audit.	Monitoring progress made by the statutory audit team against the agreed plan, and considered issues as they arose.	See page 200
Reviewed the basis of preparation of the financial statements as a going concern as set out in the accounting policies.	Recommendation made to the board to support the going concern statement.	See page 214
Reviewed the long-term viability statement proposed by management and reasons for retaining a seven-year period.	The committee challenged management on the length of the period, particularly in light of time periods provided by peer companies, but were satisfied with management's preference to provide a statement with greater certainty over a shorter period of time.	See page 142
Reviewed the accounting treatment of the refinancing of Water Plus, the group's joint venture with Severn Trent.	Considered KPMG's view and concurred with management's approach.	See page 153
Reviewed the results of the committee's assessment of the effectiveness of the 2019/20 audit.	The committee concluded that the audit was effective and a recommendation was made to the board on the reappointment of KPMG as the auditor for the year ending 31 March 2022 at the forthcoming annual general meeting.	See page 149
Reviewed whether the company's position and prospects as presented in the 31 March 2021 annual report and financial statements were considered to be a fair, balanced and understandable assessment of the company's position and prospects.	Recommendation made to the board that the 31 March 2021 annual report and financial statements was a fair, balanced and understandable assessment of the company's position and prospects.	See pages 141 and 149
Reviewed the non-audit services and related fees provided by the auditor for 2020/21 and the policy on non-audit services provided by the auditor for 2021/22.	Approved the non-audit services and related fees provided by KPMG for 2020/21 and concluded that no changes were required to the policy for non-audit services provided by the auditor.	See page 150
Negotiated and agreed the statutory audit fee for the year ended 31 March 2021 and agreed additional fee for 2019/20 reflecting increased audit work due to COVID-19.	2019/20 statutory audit fee paid as agreed by the committee. The committee approved the fees for the 2020/21 audit, including an additional fee in respect of the 2019/20 audit relating to COVID-19 audit work that are reported as part of the 2020/21 fee.	See pages 150 to 151
Reviewed the assurance processes supporting certain aspects of the TCFD and ESG sections in the narrative reporting in the 2020/21 annual report.	The committee concluded that the assurance processes supporting the narrative reporting in the annual report were satisfactory.	See page 149

Corporate governance report
Audit committee

Actions	Outcomes	Cross reference
Risk management and internal control		
Received a deep dive into the risk management process and reviewed the effectiveness of the risk management and internal control systems.	Recommendation made to the board that the risk management and internal control systems were effective.	See pages 154 to 155
Considered changes to internal control arrangements brought to the attention of the committee by KPMG	Tasked management to resolve any issues relating to internal controls and risk management systems.	See page 200
Monitored fraud reporting.	Reviewed the company's anti-fraud policies and processes and alleged incidents of fraud and the outcome of their investigation.	See page 155
Biannual oversight and monitoring of the group's compliance with the Bribery Act.	Reviewed compliance with the company's ongoing anti-bribery programme.	See page 155
Approved the strategic internal audit planning approach and reviewed reports on the work of the internal audit function from the head of audit and risk.	Monitored the implementation of the 2020/21 internal audit plan. Reviewed findings of specific internal audit and implementation of any resulting actions by management.	See page 154
Considered the issues and findings brought to the committee's attention by the internal audit team.	The committee was satisfied that management had resolved or was in the process of resolving any outstanding issues or concerns in relation to matters scrutinised by the internal audit team.	See page 154
Reviewed the quality and effectiveness of internal audit and the effectiveness of the current co-source arrangements.	The committee reviewed the process of assessment of internal audit and made recommendations for enhancement, notwithstanding the recommendations it was concluded that the internal audit team, supported by the PwC co-source resource was effective.	See page 154
Reviewed the strategic internal audit planning approach and internal audit plan for 2021/22.	Approved the internal audit plan for 2021/22.	See page 154
Undertook a competitive tender process for the internal audit co-source resource.	After analysis of the results of the competitive tender process PwC were reappointed to provide additional resource to the internal audit team.	See page 155
Governance		
Review of the committee's terms of reference	No changes were made to the committee's terms of reference during the year.	
Considered the Brydon and Kingman Reviews and established processes to consider the BEIS consultation report 'Restoring trust in audit and corporate governance'.	Process in place to consider our draft response and next steps in relation to the BEIS consultation.	
Reviewed the conclusions of the committee's annual evaluation. The evaluation was externally facilitated by Independent Audit Limited (IAL). The review explored the effectiveness of: the fundamental reporting environment; the work of the auditor and their audit approach; and the work of internal audit along with the level of understanding of the risk management process.	All elements of the self-assessment reviewed by IAL indicated the committee was working well. The board considered the results of the review of the committee and concluded that the committee continued to be effective.	See page 135

AUDIT QUALITY

Additional audit quality processes for the 2020/21 audit

With a view to further enhancing audit quality, and in response to lessons learnt during the 2019/20 audit, KPMG proposed the following action plan for the 2020/21 audit, including:

- Providing sight of their interim control findings to the committee early in the audit process and sharing their knowledge and best practice recommendations;
- Improving the two-way communication and sharing of information and insight between the external and internal audit teams by implementing regular discussion sessions prior to the scheduled committee meetings;
- Raising audit points in a more timely manner with the financial reporting team during the audit process by holding regular discussions with the external audit team and financial reporting team; and
- Using a project manager to assist with the delivery of the year end audit cycle.

As part of its review of the 2020/21 audit in July 2021, the committee will review the effectiveness of the above processes.

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

The following section sets out the company's compliance with part of provision 25. The directors' responsibility for preparing the annual report and financial statements is set out on page 196.

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

To make this assessment, the committee received copies of the annual report and financial statements to review during the drafting process to ensure that the key messages being followed in the annual report were aligned with the company's position, performance and strategy being pursued and that the narrative sections of the annual report were consistent with the financial statements. The significant issues considered by the committee in relation to the financial statements include those identified by the auditor in their report on pages 152 to 153.

The committee received regular updates on the calculation of underlying operating profit measures as one of the principal alternative performance measures (APMs). A guide to APMs can be found on page 82.

Management enhanced the review processes to provide support to the board in forming its view on whether the accounts and financial statements were fair, balanced and understandable, as it concluded they were and set out on page 141.

Many of our regulatory performance commitments are used by management as key performance indicators and are monitored by our regulators, who set the methodology against which we report. As part of their role as auditor of UUW's annual performance, KPMG provides assurance on many of these performance commitments along with Jacobs, the technical auditor.

KPMG is required (under ISA720) to consider whether there are any material inconsistencies between the other information presented in the annual report (e.g. the strategic report), and the financial statements, taking into account the auditor's knowledge obtained in the audit, or the auditor's understanding of the legal and regulatory requirements applicable to the other statutory information. The assurance of our greenhouse gas emissions and TCFD disclosures (see pages 88 to 99), is undertaken both by third parties and our internal audit team. Our disclosures against the code are reviewed by the internal audit team and reported to the committee.

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

How we assessed the effectiveness of the statutory audit process

The committee, on behalf of the board, is responsible for the relationship with the auditor, and part of that role is to examine the effectiveness of the statutory audit process. Audit quality is regarded by the committee as the principal requirement of the annual audit process.

KPMG presented the strategy and scope of the audit for the forthcoming financial year at the meeting of the committee held in September, highlighting any areas which would be given special consideration (these key audit matters are included in the auditor's report on page 200). KPMG reported against their audit scope at subsequent committee meetings, providing an opportunity for the committee to monitor progress and raise questions, and challenge both KPMG and management.

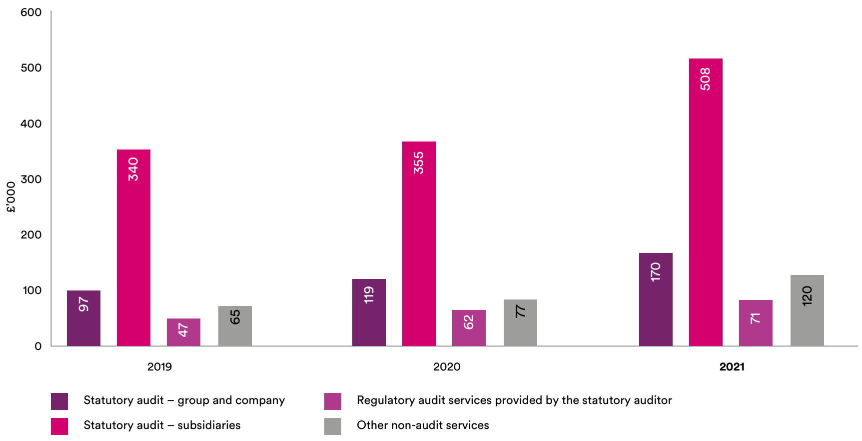
Throughout the year, management presents their up-to-date view of the key accounting issues and their resulting judgements. KPMG responds informing the committee whether, in their professional view, the judgements management propose, or have taken, are appropriate. A number of these issues manifest themselves as the significant issues considered by the committee in relation to the financial statements. For 2020/21 these are set out on pages 152 to 153, in exercising their professional scepticism, as required by auditors' professional standards, KPMG did not identify any areas of disagreement with management's judgements.

Private meetings are held at each committee meeting between the committee and representatives of the auditor without management being present to encourage open and transparent feedback by both parties. KPMG meets with management at regular intervals during the annual audit process.

Prior to the board's approval of the year end financial statements, the committee provides its view to the board

Corporate governance report
Audit committee

Statutory auditor's fees



on the outcome of the statutory audit, explaining: management's key accounting issues and judgements; the outcome of the auditor's assessment of key audit matters; other areas of audit focus and control deficiencies (if any), and how the statutory audit contributed to the integrity of the financial reporting process. The independent nature and financial expertise of committee members further contributes to the integrity of the process.

KPMG updated the committee on its ongoing Audit Quality Transformation Plan (AQTP). KPMG's AQTP includes: a more standardised audit approach; holding companies to account for the quality of the information provided in the audit process; providing more feedback to companies on the findings of their audit and providing additional senior-level support to the KPMG audit teams during the audit; all of which are well embedded in the audit process. In planning for the 2020/21 audit, KPMG provided a report to the committee on the quality interventions that they had implemented during the 2019/20 audit. Each year the committee has challenged KPMG to ensure continuous improvement.

On completion of the annual audit process the views of those involved in the audit on how well KPMG performed the audit are sought. All members of the committee, key members of the senior management team and those who regularly provide input into the audit committee or have regular contact with the auditor, complete a feedback questionnaire, thereby ensuring a wide range of views are taken into account. The questionnaire, reviewing the 2020 audit process was issued in July 2020.

Views of the respondents were sought in terms of:

- The robustness of the external audit process and degree of challenge to matters of significant audit risk and areas of management subjectivity;
- Whether the scope of the audit and the planning process were appropriate for the delivery of an effective and efficient audit;
- The quality of the delivery of the audit and whether planned quality improvements had been delivered;
- The expertise of the audit team conducting the audit;
- That the degree of professional scepticism applied by the auditor was appropriate;
- The appropriateness of the communication between the committee and the auditor in terms of technical issues;
- The quality of the service provided by the auditor;
- Their views on the quality of the interaction between the audit engagement partner, the audit senior manager and the company;
- Whether the audit process had been kept on schedule, despite the remote working due to COVID-19 restrictions of both the audit and management teams; and
- Whether the statutory audit contributed to the integrity of the group's financial reporting.

The feedback was collated and presented to the committee's meeting in September 2020. The committee noted KPMG's quality interventions as part of its AQTP to improve audit quality, including: the additional oversight provided by senior KPMG personnel during the 2019/20 audit; and the enhanced consultation to ensure consistency and challenge management's view of COVID-19. The committee concluded that the statutory audit process and services provided by KPMG were satisfactory and effective, although areas for further enhancement were agreed (see page 149).

How we assessed the independence of the statutory auditor

The following section sets out the company's compliance with part of provision 26.

There are two aspects to auditor independence that the committee monitors to ensure that the auditor remains independent of the company.

First, in assessing the independence of the auditor from the company, the committee takes into account the information and assurances provided by the auditor confirming that all its partners and staff involved with the audit are independent of any links to United Utilities. KPMG confirmed that all its partners and staff complied with their ethics and independence policies and procedures which are fully consistent with the FRC's Ethical Standard, including that none of its employees working on our audit hold any shares in United Utilities Group PLC. KPMG is required to provide written disclosure at the planning stage of the audit in the form of an independence confirmation letter. Their letter discloses matters relating to their independence and objectivity, including any relationships that may reasonably be thought to have an impact on its independence and the integrity and objectivity of the audit engagement partner and the audit staff. The audit engagement partner must change every five years and other senior audit staff rotate at regular intervals.

Secondly, the committee develops and recommends to the board the company's policy on non-audit services and associated fees that are paid to KPMG. In accordance with the FRC's Revised Ethical Standard (2019), an auditor is only permitted to provide certain non-audit services to public interest entities (i.e. United Utilities Group PLC) that are closely linked to the audit itself or that are required by law or regulation, as such services could impede their independence. Permitted non-audit services fees paid to the statutory auditor are subject to a fee cap of no more than 70 per cent of the average annual statutory audit fee for the three consecutive financial periods preceding the financial period in which the cap applies.

The 70 per cent non-audit services fee cap has been applied to the group for the year ended 31 March 2021. The average of audit fees is £430,000 (calculated as the average of the audit fees for the three preceding financial years (2020: £474,000; 2019: £437,000; 2018: £379,000). Non-audit services fees during the year were £119,500, (2020: £77,000; 2019: £65,000) so well below the cap of £301,000 (70 per cent of £430,000). In 2021, fees for non-audit services represent 27.8 per cent of the average audit fees on which the cap is based. The committee revised the non-audit services policy incorporating the 70 per cent fee cap as described above with effect from 1 April 2017. The company's non-audit services policy reflects the FRC's Revised Ethical Standard (2019). Permitted services (which remain subject to the 70 per cent cap, apart from the regulatory audit) can be approved by the CFO subject to a cap of £10,000 applied for individual items. Individual items in excess of £10,000 require the approval of the committee. Auditor-provided permitted services include the non-audit fees paid to the statutory auditor for: the interim review; the regulatory audit; agreed-upon procedures for regulatory reporting and the Euro Medium Term Note Programme and Law Debenture Trust compliance work.

Fees for non-audit services paid to KPMG include the cost of the UUW regulatory assurance work they undertake, which is separate to the regulatory audit. While this work could be performed by a different firm, the information is in fact more granular breakdowns of data that form part of the statutory audit, and by KPMG undertaking the work it reduces duplication and saves considerable cost.

During the year, the committee agreed additional fees of £100,000 in relation to the additional audit work impacted by COVID-19 as part of the 2019/20 audit. These fees were agreed subsequent to the finalisation of the 2019/20 accounts are therefore included in the audit fees disclosed for 2020/21.

Taking into account our findings in relation to the effectiveness of the audit process and in relation to the independence of KPMG, the committee was satisfied that KPMG continues to be independent, and free from any conflicting interest with the group.

Statutory auditor reappointment for the year ending 31 March 2022

The following section sets out the company's compliance with part of provision 26.

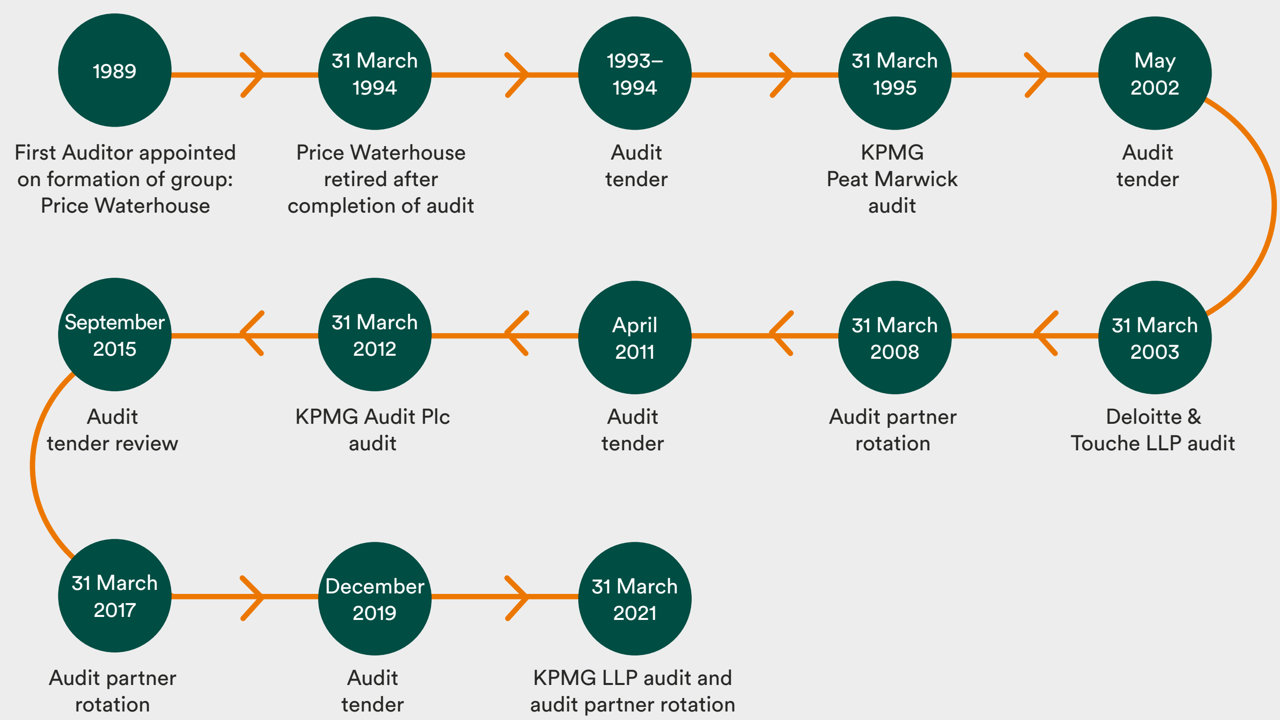
The 2020/21 year-end audit has been KPMG's tenth consecutive year in office as auditor; they were reappointed after the committee conducted a formal tender process in December 2019 and as reported by the committee in 2020. Prior to this, a formal tender was last undertaken in 2011, and resulted in the appointment of KPMG who thereafter presented their report to shareholders for the year ended 31 March 2012. An audit tender review was held in September 2015. The diagram shown below shows the historical tendering and rotation of the role of statutory auditor. The company, as a public interest entity, is required to conduct a competitive tender process every ten years, and rotate auditors after 20 years at most. As a matter of good practice, the committee continually keeps under review the performance of the auditor.

The 2020/21 audit has been the first year for Ian Griffiths as audit engagement partner. The audit engagement partner changes at least every five years.

United Utilities has complied fully with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 for the year ended 31 March 2021.

At its meeting on 19 May 2021, the committee recommended to the board that KPMG be proposed for reappointment for the year ending 31 March 2022 at the forthcoming AGM in July 2021. There are no contractual obligations that restrict the committee's choice of auditor; the recommendation is free from third-party influence and no auditor liability agreement has been entered into.

ROTATION OF EXTERNAL AUDITOR TO THE GROUP



Corporate governance report
Audit committee

Interactions with the Financial Reporting Council (FRC)
During the year, the FRC undertook a review of the company's annual report and accounts for the year ended 31 March 2020, which resulted principally in queries relating to disclosures associated with the consolidated statement of cash flows (see page 212). These queries were quickly resolved to the FRC's satisfaction and their review was closed. To provide greater clarity, the group has provided enhanced, voluntary disclosure on these and other matters in this year's financial statements. In their correspondence, the FRC states that their review provides no assurance that the company's accounts are correct in all material respects; the FRC's role is not to verify the information provided but to consider compliance with reporting requirements. The FRC last reviewed and corresponded with the company in relation to the 31 March 2016 accounts.

Going concern and long-term viability
The committee challenged and scrutinised management's detailed assessment of the group's long-term viability and its ability to continue as a going concern. In doing this the committee took into account the risks facing the business, and its ability to withstand a number of severe but reasonable scenarios. Having considered management's assessment, the committee approved the long-term viability statement set out on page 142.

Significant issues considered by the committee in relation to the financial statements

Significant issues considered	How these were addressed by the committee
Impact of COVID-19 – the impact of the COVID-19 pandemic resulted in higher levels of estimation uncertainty and considerably more judgement being required in preparing the financial statements for the year ended 31 March 2020. During the year ended 31 March 2021, the committee has considered how the situation has developed in order to revisit these significant estimates and judgements.	The impacts of the pandemic on the issues considered are outlined below, where applicable. Broadly, with the passage of time and as more data relating to the key areas impacted by the pandemic has become available, the level of estimation uncertainty has fallen compared with the prior year when the pandemic was still in its early stages.
Capitalisation of fixed assets (see pages 201, 216 and 225 to 226 and 256) – fixed assets represents a subjective area, particularly in relation to costs permitted for capitalisation and depreciation policy.	The committee assessed the reasonableness of the group's capitalisation policy and the basis on which expenditure is determined to relate to enhancement or maintenance of assets and, having considered the work performed by KPMG in this area, deemed both to be appropriate; The committee challenged the controls around ensuring the accuracy of capital accruals making up part of the total amount of fixed assets capitalised during the year, and satisfied itself that controls in this area were adequate; and The committee reviewed the recovery of the capital overhead rates that it had approved in the year ended 31 March 2020 for the five-year regulatory period ending 31 March 2025. The committee concluded that the rates remain appropriate, noting that it is early in this period and therefore the continuing appropriateness of the rates used will be kept under review.
Revenue recognition and allowance for doubtful receivables (see pages 201, 215 to 216, 227 to 228 and 255) – due to the nature of the group's business, the extent to which revenue is recognised and doubtful customer debts are provided against is an area of considerable judgement and estimation. This has particularly been the case in the current and prior year, where the economic impacts of COVID-19 have been highly uncertain, though compared with the prior year these judgements and estimates have been increasingly informed by the availability of more data in relation to consumption of services and customer payment patterns under the conditions brought about by the pandemic.	The committee reviewed the approach taken by management in estimating the impact of changing consumption patterns for both household and non-household customers during periods of lockdown, and the implications this has for estimating the amount of unbilled revenue to recognise for customers with water meters. The committee noted that the level of estimation required has reduced throughout the year, as more meter reads covering periods of changing consumption patterns have been performed. The committee satisfied itself that management's approach to estimating the level of revenue to recognise has been robust and has been appropriately adapted as more data has become available; and The committee reviewed management's assessment of the impact the pandemic appears to have had on the level of doubtful debt and credit note provisioning, recognising that the situation remains uncertain as government support schemes are set to unwind in future periods. The committee challenged management's judgement around the appropriate period over which to consider cash collection history in assessing the level of expected future credit losses, and concurred that the judgement around the period chosen was appropriate.
Retirement benefits (see pages 202, 230 to 231, 248 to 253 and 258) – the group's defined benefit retirement schemes are an area of considerable judgement, the performance and position of which is sensitive to the assumptions made. The group employs the services of an external actuary to determine the calculation of the net retirement benefit surplus and determine the appropriate assumptions to make.	The committee sought from management an understanding of changes to the methodology and assumptions used in calculating the defined benefit scheme surplus, including an expansion of the corporate bond population used in deriving the discount rate, the application of an inflation risk premium in determining the RPI inflation assumption, and a reduction in the long-term rate of improvement assumed in the mortality assumptions adopted. Having challenged the rationale for making these changes and considered how they compare with market practice and the requirements of the relevant accounting standards, the committee concluded that the resulting assumptions were appropriate and balanced in estimating the level of defined benefit obligations and therefore the net retirement benefit surplus.

Significant issues considered	How these were addressed by the committee
Accounting for loans to the Water Plus joint venture (see pages 216 to 217, 226 to 227 and 253 to 254) – during the year ended 31 March 2020 the carrying value of the group's long-term interest in Water Plus, comprising its equity investment and zero coupon loan notes extended to the joint venture, was reduced to £nil as a result of significant losses recorded by Water Plus due to the COVID-19 pandemic. During the year ended 31 March 2021, the group and its joint venture partner, Severn Trent, each agreed to refinance £32.5 million of revolving credit facilities extended to Water Plus by replacing it with additional long-term capital, which took the form of equity shares issued in April 2021. This resulted in an increase in the group's long-term interest as at the reporting date and the £32.5 million facility was included in the statement of financial position in the form of a non-current receivable. Accordingly the previously unrecognised brought forward Water Plus losses, were set against this additional long-term interest.	Having satisfied itself as to the rationale for refinancing part of the loans extended to Water Plus, the committee considered whether the conditions existed as at the reporting date to account for the £32.5 million revolving credit facility as part of the group's long-term interest in Water Plus, and therefore the appropriateness of the recognition of current and prior year losses against this balance. Having sought to understand alternative accounting approaches that were considered, the committee concluded that the nature of the balance and the conditions extant at 31 March 2021 were such that it formed part of the group's long-term interest at the reporting date and that it was satisfied with how this is presented in the financial statements; and The committee reviewed and challenged management's updated assessment of expected credit losses in relation to loans to Water Plus, concluding that the assumptions and judgements underpinning the assessment remain reasonable, and noting that the reduction in the required allowance was primarily driven by a reduction in the level of exposure to future credit losses resulting from the refinancing of the £32.5 million facility with new equity.
Accounting for the disposal of the group's stake in its joint venture, AS Tallinna Vesi (Tallinn Water) (pages 226 to 227) – during the year the group disposed of its 35.3 per cent stake in AS Tallinna Vesi, which gave rise to a profit on disposal of £36.8 million.	The committee noted the proposed accounting approach for the disposal of the Tallinn Water JV and after taking account of the specific circumstances and the views of management and KPMG, concluded that the approach and presentation in the financial statements was appropriate.
Derivative financial instruments (see pages 240 to 247 and 257 to 258) – the group has a significant value of swap instruments, the valuation of which is based upon models which require certain judgements and assumptions to be made. Management performs periodic checks to ensure that the model-derived valuations agree back to third-party valuations and KPMG check a sample against their own valuation models.	The committee noted that the periodic checks performed by management had been completed at the year end reporting date, and that KPMG had undertaken their testing with no significant issues identified.
Provisions and contingent liabilities (see pages 232, 234 and 258) – the group provides for contractual, legal and environmental claims brought against it based on management's best estimate of the value of settlement, the timing of which is dependent on the resolution of the relevant legal claims. Judgement is also required in determining when contingent liabilities exist that require disclosure in the financial statements.	The committee assessed and challenged the appropriateness of the basis on which provisions are recognised, and management's estimate of the value applied to individual claims, focusing particularly on instances where new provisions were required or where the likelihood of financial outflow was deemed to have diminished such that provisions were no longer needed and were therefore released. The committee concluded that the approach to provisioning was appropriate and that management's best estimates were reasonable; and The committee considered the reasonableness of disclosures made in respect of contingent liabilities, challenging management as to whether any provision should be recognised in the financial statements and concluding that the recognition criteria had not been met and therefore that disclosure as contingent liabilities was the most appropriate approach.
Taxation (see pages 222 to 223, 231 and 255 to 256) – judgement is required in assessing provisions for potential tax liabilities and in considering the recoverability of deferred tax assets.	The committee considered the tax risks that the group faces and the key judgements made by management underpinning the provisions for potential tax liabilities and deferred tax assets. In addition, the committee took account of KPMG's assessment of these provisions. Based on the above, the committee was satisfied with the judgements made by management.
Alternative performance measures (APMs) (see pages 82 to 83) – during the year the group revisited the adjustments made in arriving at the underlying profit measures reported in its APMs. This resulted in the removal of adjustments for: restructuring costs in arriving at underlying operating profit as a matter of course, unless highly material; net pension interest and capitalised borrowing costs in arriving at underlying net finance expense; and agreement of prior years' tax matters relating to annual tax rebates received as a result of the group's approach to paying tax.	The committee also considered the implications of these changes for the group's measure of effective interest rate which, while not an alternative to a GAAP measure of financial performance, expresses the underlying interest cost as an effective interest rate on the nominal value debt and therefore provides a useful comparison against the Ofwat's allowed cost of debt to illustrate financing outperformance during the period versus the regulatory determination. The committee concurred with management's view that it is appropriate to include effective interest rate as a measure alongside other APMs in order to increase transparency, and that in reaching this rate it is appropriate to adjust for capitalised borrowing costs and net pension interest to be consistent with the regulatory economics; and In considering management's judgements around adjusting items, the committee satisfied itself that as operating under the conditions brought about by the COVID-19 pandemic has become part of normal business practice, adjusting for COVID-19 related items becomes more subjective and therefore APMs could become less reliable. The committee therefore endorsed management's approach of not adjusting for such items in the current year.
Net debt disclosure in the financial statements (see pages 236 to 237) – following the alignment of rating agency approaches to defining net debt, the group has amended its definition of net debt reported in the financial statements as set out in note A2 (pages 236 to 237) to now exclude the fair value of derivatives hedging future interest rates, power derivatives, and the fair value of inflation swaps (excluding the principal accretion element).	The committee challenged management as to why the updated definition, which excludes the fair value of derivatives hedging future interest rates, power derivatives, and the fair value of inflation swaps (excluding the principal accretion element), gives a more useful view of the group's net debt, ultimately satisfying itself that the updated definition more closely aligns to definitions used by credit rating agencies and the approach taken by industry peers, as well as giving a better reflection of the regulatory economics associated with the group's borrowings and treasury management.

Corporate governance report
Audit committee

Internal controls and risk management systems
The main features of the group's internal controls and risk management systems are summarised below:

Internal audit function
The internal audit function is a key element of the group's corporate governance framework. Its role is to provide independent and objective assurance, advice and insight on governance, risk management and internal control to the audit committee, the board and to senior management. It supports the organisation's vision and objectives by evaluating and assessing the effectiveness of risk management systems, business policies and processes, systems and key internal controls. In addition to reviewing the effectiveness of these areas and reporting on aspects of the group's compliance with them, internal audit makes recommendations to address any key issues and improve processes and, as such, provides an indication of the behaviours being exhibited by employees in the areas under review. Once any recommendations are agreed with management, the internal audit function monitors their implementation and reports to the committee on progress made at every meeting.

A five-year strategic audit planning approach is applied. This facilitates an efficient deployment of internal audit resource in providing assurance coverage over time across the whole business, as well as greater variation in the nature, depth and breadth of audit activities. This strategic approach supports the annual audit plan, which is then endorsed by management, and which the committee reviews, challenges and approves. The plan focuses the team's work on those areas of greatest risk to the business. Building on the strategic planning approach, the development of the plan considers risk assessments, issues raised by management, areas of business and regulatory change, prior audit findings and the cyclical review programme. The purpose, scope and authority of internal audit is defined within its charter which is approved annually by the audit committee. As set out in the charter, internal audit perform their work in accordance with the mandatory aspects of the International Professional Practice Framework of the Chartered Institute of Internal Auditors; and with integrity (honestly, diligently and responsibly) and objectively (without conflicts of interest).

Internal audit, led by the head of audit and risk, covers the group's principal activities and reports to the committee and functionally to the CFO. The head of audit and risk attends all scheduled meetings of the audit committee, and has the opportunity to raise any matters with the members of the committee at these meetings without the presence of management. He is also in regular contact with the chair of the committee outside of committee meetings.

The in-house team is expanded as and when required with additional resource and skills co-sourced from external providers. The committee keeps the relationship with co-source providers under review to ensure the independence of the internal audit function is maintained and there is a documented process to manage possible conflicts of interest with the co-sourced resource. Ensuring that any co-source resource remain independent in the course of its work is crucial to the integrity of its work. During the year, PwC was re-appointed as co-source resource provider following a competitive tender process (see page 155).

The internal audit function liaises with the statutory auditor, discussing relevant aspects of their respective activities which ultimately supports the assurance provided to the audit committee and board. During the year, the committee reviewed the current operating model, in particular the balance of in-house versus co-sourced resource, and concluded that, while minor improvements were identified, the current approach was satisfactory.

Assessing the effectiveness of the internal audit function
The effectiveness of the internal audit function's work is continually monitored using a variety of inputs, including the ongoing audit reports received, the audit committee's interaction with the head of audit and risk, an annual review of the department's internal quality assurance report, a quarterly summary dashboard providing a snapshot of the progress against the internal audit plan tabled at each committee meeting as well as any other periodic quality reporting requested.

An annual stakeholder survey in the form of a feedback questionnaire is circulated to committee members, senior management and other managers who have regular contact with the internal audit function, including representatives from the auditor KPMG and the co-source audit provider PwC. The responses were anonymous to encourage open and honest feedback, and were consistently favourable, as were previous surveys.

Periodically, the quality and effectiveness of the internal audit function is also assessed externally, with the most recent review being undertaken in early 2019. The committee has received regular updates during the year from the head of audit and risk on the impact of the pandemic on the schedule of work of the internal audit team, due to remote working and social distancing measures. Some re-phasing of the original work was undertaken, with the team keeping on track with re-planned work. Only one audit, which required access to a third party's site, was deferred, with agreement by the committee, to the 2021/22 audit plan.

Taking all these elements into account, the committee concluded that the internal audit function was an effective provider of assurance over the organisation's risks and controls and appropriate resources were available as required.

Risk management systems
The committee receives updates and reports from the head of audit and risk on key activities relating to the company's risk management systems and processes at every meeting. These are then reported to the board, as appropriate. The group designs its risk management activities to manage rather than eliminate the risk of failure to achieve its strategic objectives.

The CFO has executive responsibility for risk management and is supported in this role by the head of audit and risk and the corporate risk manager and his team. The group audit and risk board (GARB) is a sub-committee of the executive team. The GARB meets quarterly and reviews the governance processes and the effectiveness and performance of these processes along with the identification of emerging trends and themes within and across the business. The work of the GARB then feeds into the information and assurance processes of the audit committee and into the board's assessment of risk exposures and the strategies to manage these risks.

Supplementing the more detailed ongoing risk management activities within each business area, the biannual business unit risk assessment process (BURA) seeks to identify how well risk management is embedded across the different teams in the business. The BURA involves a high-level review of the effectiveness of the controls that each business unit has in place to mitigate risks relating to activities in their business area, while identifying new and emerging risks and generally to facilitate improvements in the way risks are managed. The outcome of the BURA process is communicated to the executive team and the board. This then forms the basis of the determination of the most significant risks that the company faces which are then reviewed by the board. The group utilises risk management software to underpin the company's risk management process. The maturity of the risk management framework and its application across the business is assessed on an annual basis against a defined maturity model. This assessment provides an objective appraisal of the degree of maturity in how the risk management system is being applied and the quality of each risk in terms of quantification and management. The results of the maturity assessment are reported to the GARB, and actions agreed with business units.

An external assessment of the risk management process last took place in 2017/18.

The committee received a 'deep dive' session on the risk management process. This provided an explanation of the process of identification and assessment of risk along with the governance mechanisms in place prior to the reporting of the risk profile to the board.

Internal controls

The committee reviews the group's internal control systems and receives updates on the findings of internal audit's investigations at every meeting, prior to reporting any significant matters to the board. Internal control systems are part of our 'business as usual' activities and are documented in the company's internal control manual which covers financial, operational and compliance controls and processes. Internal control systems are the responsibility of the CFO, with the support of the GARB, the financial control team and the internal audit team, although the head of audit and risk and his team are directly accountable to the audit committee.

Confirmation that the controls and processes are being adhered to throughout the business is the responsibility of managers, but is continually tested by the work of the internal audit team as part of its annual plan of work which the committee approves each year as well as aspects being tested by other internal assurance providers. Compliance with the internal control system is monitored annually by the completion of a self-assessment checklist by senior managers in consultation with their teams. The results are then reviewed and audited on a sample basis by the internal audit team and reported to the committee.

Anti-fraud and anti-bribery

The audit committee is responsible for reviewing the group's procedures for detecting fraud, and the systems and controls for preventing other inappropriate behaviour. In the first instance of an incident being reported, a summary of the allegations is passed to the fraud and whistleblowing committee (consisting of the company secretary, customer services and people director, commercial director and head of internal audit and risk) to decide on the appropriate course of action and investigation and by whom.

INTERNAL AUDIT CO-SOURCE COMPETITIVE TENDER

During the year, the committee led and supervised a formal tender process for the internal audit co-source resource. The contract with the incumbent, PwC, was due to expire on 31 March 2021. The request for proposal was issued in December 2020. Five proposals were received, which were evaluated on a weighting of 85 per cent technical and 15 per cent commercial. After initial analysis, three proposals progressed to the presentation stage in front of the tender review panel made up of audit committee members and senior members of the finance team. Taking into account both technical and commercial scores, PwC achieved the highest score and was re-appointed.

During the year, the audit committee was kept fully apprised in regular updates on the progress and findings of investigations of cases of alleged fraud and any remedial actions taken. A number of employees have been selected and received specialist training in order to conduct investigations of cases of alleged fraud.

In line with the group's anti-fraud culture and zero-tolerance attitude towards fraud, a fraud incident forum has been established to identify and understand potential threats, and optimise the group's response and mitigation and ensure consistency across the business.

The company has an anti-bribery policy to prevent bribery being committed on its behalf, which all employees must follow, and processes in place to monitor compliance with the policy. Employees in certain roles are required to complete anti-bribery training materials. As part of the anti-bribery programme, employees must comply with the group's hospitality policy. The hospitality policy permits employees to accept proportionate and reasonable hospitality for legitimate business purposes only. Our employees and representatives of our suppliers must comply with the group's sustainable supply chain charter which explains that we will not tolerate corruption, bribery and anti-competitive actions and we expect our suppliers to comply with applicable laws and regulations, and in particular never to offer or accept any undue payment or other consideration, directly or indirectly, for the purposes of inducing any person or entity to act contrary to their prescribed duties.

As part of the internal control self-assessment checklist (part of the group's internal control processes), senior managers in consultation with their teams are required to confirm, among other things, that they have complied with the group's anti-bribery and hospitality policies. The anti-bribery programme is monitored and reviewed biannually by the committee. Our United Supply chain approach sets out that we do not tolerate corruption, bribery and unfair anti-competitive actions on our own behalf or that of our suppliers.

The anti-bribery policy is available at **unitedutilities.com/corporate/about-us/governance**

The United Supply chain approach is available at **unitedutilities.com/corporate/about-us/governance/suppliers/delivering-value/united-supply-chain**