



Methodology Statement for Accounting
Separation 2014/15
(including upstream services data)

Affinity Water Limited

June 2015

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1 – Introduction

1.1 Purpose

The purpose of this document is to set out our approach on accounting separation. Ofwat require this document to be submitted alongside the Regulatory Accounts.

1.2 Scope

This document only relates to the appointed business of Affinity Water Limited (AWL).

This document should be read in conjunction with Ofwat’s guidelines on accounting separation (RAG 4.04) and regulatory tables published in our accounts.

1.3 Overview

In 2010/11 Ofwat required each company to produce accounting separation tables for Operating Expenditure, Current Cost Assets and Deprecation which were submitted as a part of the June Return.

In 2011/12 Ofwat no longer required companies to submit a June Return, however companies were still asked to submit accounting separation data with an accompanying Methodology Statement. Affinity Water published the accounting separation tables as a part of their Regulatory Accounts.

For 2012/13, we continued to publish accounting separation tables in accordance with the revised Regulatory Accounting Guidelines (RAG 4.04 as published in February 2013) and supported by Information Notice IN 13/01. We subsequently published a supplementary document with updated accounting separation tables.

For the past two years (2013/14 and 2014/15) the accounting separation tables are again published in our Regulatory Accounts in accordance with the Regulatory Accounting Guidelines and supported by Information Notice IN 15/02.

1.4 Significant Changes Year on Year

Total Operating Cost

Operating Cost	2013/14	2014/15	Movement
Wholesale	£197.8m	£184.0m	£13.8m
Retail	£32.4m	£36.3m	(£3.9m)
Total	£230.2m	£220.3	£9.9m

Wholesale operating cost has decreased by £13.8m compared to prior year. This decrease is largely driven by capital maintenance expenditure which has dropped by £7.9m. The remaining difference of £5.9m is within operating expenditure.

The decrease of £7.8m in capital maintenance expenditure can be explained by:-

- £11.2m decrease in Infrastructure Renewals Charge (IRC) reflecting lower renewals expenditure forecast for AMP 6 in our AMP 6 Business Plan than previously forecast in our calculation of IRC. In AMP 5 we reduced the unit cost of pipe renewal by re-examining our procurement and design processes. This efficiency saving is reflected in AMP 6 forecast renewals expenditure, together with the investment we have made during AMP 5 to stabilise our network from a 'marginal' assessment given by Ofwat of the serviceability of our assets at the start of AMP 5.
- £3.2m increase in Current Cost Depreciation due to the increased number (and value) of projects capitalised given that 2014/15 was the final year of the AMP.
- £0.06m decrease in Amortisation of deferred credits resulting from fully amortised balances in the prior year.

The decrease of £5.9m in operating expenditure can be explained by:-

- £7.3m decrease in Service Charges due to £3.9m reimbursement of Environmental Improvement Unit Charges (EIUC) levied from 2008 to 2013, £1.7m credit notes received in respect of EIUC levied in 2013/14 and £1.7m EIUC levied in 2013/14 not repeated this year.
- £0.8m decrease in Power due to lower usage of energy.
- £1.7m increase in Other Operating Expenditure due to atypical activity relating to payroll and recruitment costs with General and Support costs. This is offset by operating efficiencies in the year which has driven down cost.
- £0.5m increase in Bulk Supply Imports.

Retail operating cost has increased by £3.9m compared to prior year. This increase is largely driven by operating expenditure which has risen by £3.4m. The remaining difference of £0.5m is within capital maintenance expenditure.

The increase of £3.4m in operating expenditure can be explained by:-

- £1.7m increase in Other Operating Expenditure due to atypical activity relating to payroll and recruitment costs with in General and Support costs. This is offset by operating efficiencies in the year which has driven down cost.
- £1.0m increase in Doubtful Debt due to a rise in the level of uncollectable debt.
- £0.4m increase in Meter Reading due to a rise in the metered customer base and an improvement in allocation of metering activity. Last year this cost was within Other Direct Cost.
- £0.3m increase in Customer Services mainly driven by higher payment handling costs for card charges.
- £0.03m decrease in Debt Management mainly driven by higher recovery of first placement debt collection agency costs through £50 levies to customers.

The increase of £0.5m in capital maintenance expenditure can be explained by:-

- £0.5m increase in Current Cost Depreciation due to the increased number (and value) of projects capitalised given that 2014/15 was the final year of the AMP.

Methodology

Improvements have been made to certain allocations to ensure we are fully compliant with Ofwat's guidelines on Accounting Separation. See below for a list of improvements made this year:-

1. Service to Developers – In 2013/14 we had costs which related to aborted developer service enquires split between wholesale and retail. This year we are charging application fees for providing quotes, site visits and any administrative activities. This additional income covers all costs which relate to aborted enquires.
2. Retail Cost Allocation between household and non-household:-
 - a. Payment Handling – In 2013/14 we allocated this cost on the number of bills raised for household and non-household customers. This year we have produced a report which counted all payments received from customers in 2014-15 split by household and non-household.
 - b. Doubtful Debt – In 2013/14 we allocated the total charge based on the percentage of actual write-offs in the year categorised by household and non-household customers. This year write-offs and movement in provision have been directly allocated based on customer type.

2 – System and Structures

2.1 System

Affinity Water uses Oracle as its financial and business management system.

2.2 Structures

Our operating expenditure is primarily divided into four main directorates. These are:-

1. Asset Management
2. Community Operations
3. Customer Services
4. Support Services

The costs in these areas are split further by the use of cost centres which have individual budget holders allocated to them.

Alongside directorate reporting we also report total operating expenditure by cost type. The key cost types are:-

1. Employment
2. Power
3. Rates
4. Chemicals
5. Subcontracting
6. Bad debt charge
7. Environmental charges
8. Bulk Water Purchases

3 – Operating Expenditure Allocation Assumptions

3.1 Approach Taken

The core data is taken from the year end Trial Balance (TB) and this forms the basis for the model. Each line of the TB is individually allocated either to a Business Unit (as defined by Ofwat in RAG 4.04 – Water Resources, Raw Water Distribution, Water Treatment, Treated Water Distribution and Retail), classified as a Balance Sheet item, as Not Applicable or as an Overhead. This allows a clear audit trail back to the audited accounts.

3.2 Direct Cost

The first level driver for this allocation is the cost centre number. However, where the cost centre does not match directly to a Business Unit, there is a degree of percentage allocation, based on cost centre manager assessment or other analysis as appropriate.

The second level for cost allocation is the detail code used to describe an expenditure type. This allocation is used for the wholesale table (A7), where we have to report costs at the following level of detail:

1. Power
2. Service Charges
3. Bulk Imports
4. Other Operating Expenditure (Such as Employment, Hired and Contracted, Materials, Associated Companies and Other Direct Cost)
5. Local Authority Rates

In order to simplify the model we have grouped together, wherever possible, cost centres and detail codes into 18 allocation categories. Each category has a percentage allocation assumption, allocating costs to the various business units. These percentages are periodically reviewed and we continue to ensure the managers have supporting evidence for this split. Please refer to the below table for detail.

Each cost centre is given an allocation category, this drives the percentage allocation applied and the output is a financial value allocated to each business unit, per TB line. These detail codes have been analysed and allocated to one of the below categories, in a consistent manner.

This is fully detailed in Appendix I.

Allocation % Applied to TB			INPUT	By adjusting these percentages you can re-allocate costs between business units										
Ref Type	Basis	Last reviewed	Cost Centres/Detail Codes	Wholesale				Retail	G&S	Business			Total	
				Water resources	Raw water	Water treatment	Treated water	Retail		Rates	Atypical	Regulation		
1	BS/Income	NA	Mar-15	00000/11111	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2	Power	Pump head analysis	Mar-15	21191 and lines classified as power costs in other CC's	0.00%	15.52%	67.87%	16.61%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
3	Supply		Mar-15	21135/61/71/81	0.00%	5.00%	85.00%	10.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
4	EA Charges	OFWAT Guidance	Mar-15	21161- 841010 & detail codes 841919, 881312, 942206, 942207	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
5	Imports	Guidance	Mar-15	Detail codes designated as "Bulk Water..."	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
6	Atypical	Annual review	Mar-15	Various	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	100.00%
7	Estates	Per Manager	Mar-15	21123	6.12%	6.02%	37.59%	50.27%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
8	Karstic	Per Manager	Mar-15	21142	0.00%	30.00%	60.00%	10.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
9	Production Network	Per Manager	Mar-15	21112/13/25/27/32/52	0.00%	5.00%	85.00%	10.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
10	Services Customer	Per Manager	Mar-15	21223/25/31/32/41/42/43/45	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
11	Operations	Per Manager	Mar-15	21213/245/251/254/302/47	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
12	Leakage	Per Manager	Mar-15	4/475 40911/961	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
13	Asset M'tment	Per Manager	Mar-15	21471/2/3	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
14	Water Quality	Per Manager	Mar-15	21195/96 21301/21303	32.26%	0.00%	29.03%	38.71%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
15	Rates	CC GBV per OFWAT	Mar-15	23502/03/05/06/07/08	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	100.00%
16	Regulation	Guidance	Mar-15	xxxxx-942204	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	100.00%
17	Retail		Mar-15	21485	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
18	Overheads		Mar-15	21211/21421/22/51/52/53/54/55/56/57/58/59/60/61	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	100.00%
			Mar-15	40204/05/07	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	100.00%
			Mar-15	Various	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	100.00%

3.3 Indirect Costs

Every effort has been made to minimise the number of TB lines that are not directly allocated to a business unit; however there are five expense categories that require proportional allocation across the business units. These are:

- General and Support (G&S)
- Local Authority Rates
- Exceptional (Atypical)
- Other business activity (Regulation)

General and Support

We have six main cost types within General and Support. These costs are allocated amongst the five business units and Other Business Activity (Regulation). The below tables show what type of costs are included in General and Support and basis of allocation.

Type of Cost	Basis of Allocation
Human Resources	Number of Employees
Facilities Management (Head Office)	Floor space of Head Office
Procurement	Current year's Hired & Contracted and Material spend
Information Technology	1. Direct allocation of key systems 2. Number of Employees for remaining cost
Legal and Insurance	1. Management estimate on insurance premium and claim history 2. Number of Employees for remaining cost
Other: Finance, General Management, Corporate Services, Health and Safety, External Communication and Pension service cost.	Number of Employees

Local Authority Rates

Cumulo rates are allocated on the basis of GMEAV as at March 2015. Head office building rates are allocated on floor space of head office.

Exceptional items

This requires an annual review, to identify any costs that could be classified as Exceptional as per UKGAAP FRS3.

Paragraph five to FRS 3 defines an exceptional item as:

“Material items which derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually, or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.”

We have no exceptional items for 2014/15.

Other business activity (Regulation)

This cost includes direct allocation from the regulation cost centre plus an element of general and support cost based on the allocation mentioned above. This cost is then allocated on an even basis (1/5) across the five business units as per Ofwat guidelines.

3.4 Operating Cost Analysis for Wholesale Business

The table below shows how costs are allocated to each line in table A7.

Allocation to cost driver

Table Line	Activity / Cost Type	Cost Driver	Allocation to Business Unit (BU)
Power	Power	Direct allocation to Water Treatment by use of specific expenditure codes and cost centres.	Basis is aggregated Average Pumping Head data for each BU.
Income treated as negative expenditure	Power	Not currently applicable.	Not currently applicable.
Service Charges	Abstraction Charge	Actual charges from the Environment Agency allocated to wholesale.	Direct allocation to Water Resources by use of specific expenditure codes and cost centres.
Bulk Supply Imports	Bulk Supply Import	Direct allocation to Water Treatment by use of specific expenditure codes and cost centres.	Direct allocation to Water Treatment by use of specific expenditure codes and cost centres.
Other Operating Expenditure	<u>Direct cost</u> Employment Materials Hired & Contracted Other Direct Cost	Costs directly allocated to wholesale.	The costs of employment, materials, hired & contracted services and consumables are all allocated by using specific expenditure codes and cost centres. If a cost centre covers more than one BU, costs are allocated by

Table Line	Activity / Cost Type	Cost Driver	Allocation to Business Unit (BU)
	<p><u>Indirect Cost</u></p> <p>General and Support Scientific Services Other Business Activity</p>	<p>Costs indirectly allocated to wholesale.</p>	<p>management estimate.</p> <p>Other direct costs are all allocated to individual BUs via cost centres and expenditure codes. This includes cost such as Vehicle Expenditure, Mobile Phone and Other Sundry items.</p> <p>General & Support costs are applied pro-rata to direct employees within each business unit, direct allocation or split based on management estimates.</p> <p>Scientific Services – costs are allocated all to wholesale and split into BU by management estimate.</p> <p>Other Business Activity - allocated on an even basis (1/5) across the five business units.</p>
<p>Local Authority Rates</p>	<p>Local Authority Rates</p>	<p>Actual charge.</p>	<p>Cumulo Rates allocation based on GMEAV.</p> <p>Head Office Building Rates allocated based on floor space.</p>
<p>Exceptional Items</p>		<p>Actual charge.</p>	<p>Dependent on nature of cost.</p>
<p>Third Party Services</p>	<p>Total cost relating to serving Third Party Services</p>	<p>Directly coded to wholesale.</p>	<p>Non-potable water – all in raw water distribution.</p> <p>Rechargeable works – all in treated water distribution.</p> <p>Special agreements – separately calculated to reflect management estimates of resources consumed to deliver the BU.</p>

Wholesale Other Direct Cost

Please see the below table for a breakdown of cost categories and values that we have included in Other Direct Cost.

Cost Centre Description	£m	Nature of Cost
Vehicles	2.44	Cost for vehicle leasing and maintenance
Telephones	0.53	Cost for mobile telephones
Street Works	2.22	Cost of permits, fines/fees and consequential damage to highway
Other	-0.03	Sundry income
Total	5.16	

3.5 Operating Cost Analysis for Retail Business

The retail costs include direct allocation of cost centres within our customer service department and specific transfers of cost which are accounted for in our wholesale business to comply with RAG 4.04.

An apportionment of General and Support, Local Authority Rates and Other Business Activity (Regulation) costs are allocated to retail based on the allocation discussed in Section 3.3.

Ofwat require the cost within retail to be split further into household and non-household. This split has been done directly where possible and the remaining costs have been allocated using various assumptions.

The table below shows how costs are allocated to each line in table A8.

Allocation to cost driver between household and non-household

Table Line	Activity/ Cost Type	Cost Driver	Rationale for cost driver
Customer Services	Billing	Number of household / non-household bills raised.	The cost for billing activity is directly linked to the number of bills raised. The number of bills is based on assumptions on the annual billing cycles for non-metered and metered customers.
	Payment handling, remittance and cash	Number of household / non-household receipts.	Costs for payment handling is assumed to be directly linked to type of receipt processed.
	Charitable trust donations	All household.	Actual charge is wholly attributable to household customers only.
	Vulnerable customer schemes	All household.	Actual charge is wholly attributable to household customers only.
	Non-network customer queries and complaints	Volume of annual billing contact by household / non-household customers.	Costs vary in proportion to the number of billing contacts made by customers.
	Network customer queries and complaints	Volume of annual operational contact by household / non-household customers.	Costs vary in proportion to the number of operational contacts made by customers.
Debt Management	Debt Management	Household and non-household debt collection team size.	Costs are dependent on the relative levels of debt outstanding to be collected.
Doubtful Debts	Doubtful Debts	Actual write-offs and movement in provision based on customer type.	The charge for the year is split based on actual write-offs and movement in the bad debt provision which we have split between household and non-household.
Meter Reading	Meter Reading	Number of meter reads for household / non-household.	Costs are dependent on frequency of meter reads which vary between household / non-

Table Line	Activity/ Cost Type	Cost Driver	Rationale for cost driver
			household.
Services To Developers	Services To Developers	All non-household.	Actual charge is wholly attributable to non-household customers only.
Other Operating Expenditure	Disconnections	Number of disconnections.	Actual number taken from Hi-Affinity (our billing system).
	Demand Side Water Efficiency Initiatives	All household.	Programme costs wholly attributable to household.
	Customer Side Leaks	All household.	Actual costs wholly attributable to household.
	Other Direct Costs	Either direct allocation or number of customers.	The most appropriate driver has been taken in all cases.
	General & Support	Costs are applied pro-rata to direct employees by activity, specific allocation or management estimate.	Direct and indirect costs of General and Support activities.
	Other Business Activities	Number of customers	Assumed allocation between household and non-household will follow the same proportion as customer numbers.
Local Authority Rates	Cumulo Rates Head Office Building Rates	Number of customers.	Assumed allocation between household and non-household will follow the same proportion as customer numbers.
Exceptional Items	Exceptional Items	Actual charge.	Dependent on nature of cost.
Third Party Services	Third Party Services	Direct allocation.	Dependent on service provided.

Other Direct Cost

Please see the below table for a breakdown of cost categories and values that we have included in Other Direct Cost.

Cost Centre Description	£m	Nature of Cost
Income Services	0.319	Employment and third party commission costs associated with delivering additional income through missing proprieties and voids.
Customer Services Management	0.755	Employment cost of Customer Service Management team.
Directors' Office	0.124	Employment costs for dealing with written complaints and awarding both statutory and ex-gratia compensation payments for breaching service standards.
Customer Experience Planning	0.344	Employment costs of delivering Customer Service systems enhancements and upgrade, coaching team, and resource & planning team.
Voice Of The Customer	0.122	Employment costs for administering customer feedback systems.
Commercial Services Admin	0.597	Employment costs for administration and retention/acquisition of commercial customers for appointed income streams.
Total Other Direct Cost	2.261	

4 – Billing and Collection

4.1 Outsourced Activities

Affinity Water does not outsource any of its billing and collection where the risk of collection is transferred to a third party.

Affinity Water has outsourced the following elements:-

- IT Services to Tata Consultancy Services where some of the activities are carried out in India.
- Customer Services back office correspondence workload (primarily home movers) to Steria Limited based in India.
- After initial in-house debt recovery action has taken place, we use a combination of the following UK-based agencies:
 - Inter Credit – first placement debt collection agency using letter and telephone recovery techniques to recover debt from slow or non-paying customers.
 - Fredricksons – second placement debt collection agency using letter and telephone recovery techniques and also some limited legal action to recover debt from slow or non-paying customers.
 - CARS – first and second placement debt collection agency using a combination of letters and telephone recovery techniques to recover debt from slow or non-paying customers.
 - Marstons – recovery of debt using judicial proceedings such as legal action through the courts and bailiffs.
 - Court Enforcement Services – visits to commercial customer premises and issuance of high court injunctions for commercial debts of £500 and over.

4.2 Billing in name of “The Occupier” and vacated properties

Affinity Water classifies unoccupied bulk owner properties as “occupied” if they are empty for less than 26 weeks for short-term situations such as refurbishment or change of tenancy. These properties are billed in full and then a percentage is deducted from the amount owed in recognition that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the council/housing association provides that the local authority will notify the company so that the property can be formally recorded as “empty” on the company’s billing system and, therefore, will not be billed.

The company no longer raises bills addressed to “The Occupier” when there is no consumption detected at the property. The company’s assumption is that these properties are not occupied. The company makes further enquiries and when the company receives information that the property has become occupied the status of the account will be amended, the customer’s name applied to the account and billing will commence. Where enquiries give the company reason to believe that the property is inhabited but it has not been possible to obtain the customer’s name, a bill will then be issued in the name of “The Occupier”. This only occurs for measured customers.

In each of the above cases, if a bill is sent, the company would recognise it within turnover in the regulatory accounts.

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as turnover. If the developer is no longer responsible for the property and no new occupier has been identified the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

4.3 Bad Debt Provisioning

At each reporting date, the company evaluates the collectability of debtors and records provisions for bad and doubtful debts based on experience. The bad debt provision is charged to operating costs to reflect the company's assessment of the risk of non-recovery of debtors. The bad debt provision is calculated by applying a range of different percentages to debtors of different ages. These percentages also vary between categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debtors of greater age. The value of the debt provision is sensitive to the specific percentages applied. The specific percentages applied are updated annually to reflect the latest collection performance data from the company's billing system. All debtors greater than five years old are fully provided for. Actual amounts recovered may differ from the estimated levels of recovery which could impact on operating results.

Our policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and debts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill.

Accounts are written off following all internal recovery activity and subsequent external debt collection agency activity, except as follows:

- Closed accounts under £15 are written off without any internal recovery activity.
- Closed accounts under the name of 'the occupier' are written off without any internal recovery action.
- Closed accounts under £50 are written off following all internal recovery activity where we have a forwarding address for the customer.
- Closed accounts under £100 are written off following all internal recovery activity where we have no forwarding address for the customer.

Amounts are also written off on accounts where we are still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances if the total debt contains amounts over six years old, the amount over six years old, or more, is written off.

Affinity Water's bad and doubtful debts provision policy has remained unchanged and has been consistently applied in the current and prior year.

5 – Capital Maintenance

5.1 Infrastructure Renewals Charge

The Infrastructure Renewals Charge (IRC) is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the company's independently certified asset management plan. For 2014/15, IRC has been estimated as being equal to actual renewals expenditure (IRE) for the year reflecting renewals expenditure forecast for AMP 6 in our AMP 6 Business Plan. IRC is lower than previously forecast in our calculation of IRC for 2013/14, as in AMP 5 we reduced the unit cost of pipe renewal by re-examining our procurement and design processes. This efficiency saving is reflected in AMP 6 forecast renewals expenditure, together with the investment we have made during AMP 5 to stabilise our network from a 'marginal' assessment of the serviceability of our assets at the start of AMP 5.

For accounting separation the total value of IRC is allocated to wholesale. IRC is split between two business units within wholesale – Raw Water Distribution and Treated Water Distribution. The amount of IRC allocated to Raw Water Distribution is calculated based on the proportion of our raw water mains network. The remaining IRC is allocated to Treated Water Distribution.

5.2 Key Principles – Fixed Assets

We do not have a Current Cost Asset (CCA) register. Our CCA data is compiled from the GMEAV database used within the AMP 5 Business Plan. This database has been inflated using RPI and asset expenditure for the subsequent years has been added and similarly inflated as appropriate.

Current Cost Depreciation (CCD) has been calculated as a function of the AMP 5 Business Plan CCD, adjusted for these subsequent additions amortised over their useful life.

The approach taken for the largest of the three regions (Central) has been to apportion all additions and depreciation in accordance with the split of the 2008 Business Plan asset base. The other two regions (East and Southeast) have attributed additions to the accounting separation categories on an asset by asset basis.

5.3 Fixed Assets Cost Allocation Assumptions

In order to simplify the model, assumptions were made as to how to categorise the GMEAV data. This forms the basis of the allocations across the various cost categories.

Business Plan 2008 – Fixed Assets

Each asset type is given an allocation category, this drives the percentage allocation applied and allocated to each business unit. See below table for detail.

Central Region Cost Value at March 2008 GMEAV Revaluation

		Water Resources	Raw Water Distribution	Treatment	Treated Water Distribution	Retail Household	Retail Non- h'hold
WATER RESOURCES £000	31/03/08						
Dams & Impounding Reservoirs	31,045	31,045	0	0	0	0	0
Raw Water Aqueducts	152,118	0	152,118	0	0	0	0
SW4 Assets	13,795	0	0	13,795	0	0	0
GW & GW1	594	0	0	594	0	0	0
GW2	22,843	0	0	22,843	0	0	0
GW3	41,954	0	0	41,954	0	0	0
GW4	377,477	0	0	377,477	0	0	0
Serv Resvrs	275,864	0	0	0	275,864	0	0
Water Towers	29,453	0	0	0	29,453	0	0
Intake Pumps	16,150	0	16,150	0	0	0	0
Source Pumps	70,827	70,827	0	0	0	0	0
Booster Pumps	147,558	0	0	0	147,558	0	0
Offices & Laboratories	13,766	1,721	1,721	1,721	1,721	6,505	378
Depots & Workshops	4,914	0	0	0	4,914	0	0
Vehicles	1,965	0	0	0	1,965	0	0
Telemetry	28,333	0	0	0	28,333	0	0
Computers	38,191	0	0	0	0	36,092	2,100
Lands and Roads	2,228,744	1,114,372	0	1,114,372	0	0	0
Potable Mains	3,233,560	0	0	0	3,233,560	0	0
Customer Ancillaries	696,148	0	0	0	696,148	0	0
TOTAL	7,425,300	1,217,965	169,988	1,572,756	4,419,516	42,597	2,478
		16.4%	2.3%	21.2%	59.5%	0.6%	0.0%

For the Central region the percentages above were used to allocate the 2014/15 additions (i.e. 16.4% of the total additions were applied to Water Resources, 2.3% to Raw Water Distribution etc.).

For the smaller regions, East and Southeast, the additions for 2014/15 were allocated on an asset by asset basis using management judgement. The GMEAV assets at 31 March 2008 were also allocated in this way.

5.4 Current Cost Depreciation Allocation Assumptions

As with the split of fixed assets cost, each asset type is given an allocation category, this drives the percentage allocation of the depreciation charge applied and allocated to each business unit. See below table for detail.

Central Region Depreciation Value at March 2008 GMEAV Revaluation

		Water Resources	Raw Water Distribution	Treatment	Treated Water Distribution	Retail Household	Retail Non- h'hold
WATER RESOURCES £000	31/03/08						
Dams & Impounding Reservoirs	0	0	0	0	0	0	0
Raw Water Aqueducts	0	0	0	0	0	0	0
SW4 Assets	9,424	0	0	9,424	0	0	0
GW & GW1	446	0	0	446	0	0	0
GW2	13,987	0	0	13,987	0	0	0
GW3	23,300	0	0	23,300	0	0	0
GW4	190,865	0	0	190,865	0	0	0
Serv Resvrs	191,718	191,718	0	0	0	0	0
Water Towers	20,405	0	0	0	20,405	0	0
Intake Pumps	8,096	0	8,096	0	0	0	0
Source Pumps	45,586	45,586	0	0	0	0	0
Booster Pumps	97,548	0	0	0	97,548	0	0
Offices & Laboratories	9,548	1,193	1,193	1,193	1,193	4,511	262
Depots & Workshops	2,618	0	0	0	2,618	0	0
Vehicles	1,050	0	0	0	1,050	0	0
Telemetry	19,353	0	0	0	19,353	0	0
Computers	29,211	0	0	0	0	27,605	1,606
Lands and Roads	45,427	22,714	0	22,714	0	0	0
Potable Mains	0	0	0	0	0	0	0
Customer Ancillaries	23,472	0	0	0	23,472	0	0
TOTAL	732,054	261,211	9,290	261,929	165,640	32,117	1,868
		35.7%	1.3%	35.8%	22.6%	4.4%	0.3%

For the Central region the percentages above were used to allocate the 2014/15 depreciation charge (i.e. 35.7% of the total additions were applied to Water Resources, 1.3% to Raw Water Distribution etc.).

For the smaller regions, East and Southeast, the depreciation for 2014/15 was allocated on an asset by asset basis using the same management judgement used for fixed asset costs, with each asset having an individually identified useful life.

5.5 Analysis of allocation to retail

The below table shows an analysis of assets allocated to retail. This analysis disaggregates the closing net book value (NBV) and the current cost depreciation charge for the year.

Retail	CCD £000	NBV £000
Billing System	120	663
Other Specific Retail Assets	-	-
Shared Assets allocated to the retail table	3,023	66,813
Total	3,143	67,476

To allocate the shared assets between retail and wholesale, we have taken the total value of Software & Computers plus half of the total for Offices and Laboratories and divided this by the total on the table. This has been done separately for fixed asset cost and depreciation.

Within the CCA calculations, household and non-household values have been split for every line based on the number of customers served. This resulted in 94.7% of each line being attributed to household.

6 – Trial Service Data

6.1 Allocations

The data in the Trial Service tables is derived from table A7 (Wholesale operating cost). The following allocations have been made in order to split the cost into service categories.

Water resources

The actual cost of licences is collected separately in the company's accounting system. It has been separated from the operating expenditure in this area, and entered into the abstraction licence operating expenditure. All other costs are allocated to raw water abstraction.

Raw water distribution

There is very little directly owned raw water storage within our business, therefore the approach taken was to estimate the operating expenditure for these raw water distribution facilities and subtract this cost from the total operating expenditure for raw water transport. The total estimated operating expenditure for these raw water storages is £38,000. It has been assumed that all current cost depreciation in this area relates to storage reservoirs, and that all infrastructure renewals expenditure relates to distribution assets.

Water treatment

No allocation was required for water treatment costs.

Treated water distribution

Affinity Water's accounting systems do not allow operating expenditure spent on trunk mains to be distinguished with that spent on local distribution mains. Therefore an estimate is made as to the amount of operating expenditure relating to trunk mains and the remaining cost allocated to local distribution mains. There is a small amount of operating expenditure incurred in monitoring and inspection of trunk mains, estimated to be £40,000. The vast majority of the operating expenditure is incurred in fixing burst or leaking mains. We had approximately 90 burst trunk mains in 2014/15. It is estimated that the average cost of each burst is £8,567 including reinstatement costs and consequential damage expenditure. The resulting total operating expenditure for trunk mains is £0.8m.

Infrastructure renewals charge is allocated between trunk mains and local mains in proportion to their replacement values. Replacement value is calculated by multiplying the unit cost for each type of main replacement by the length of main in each category. Current cost depreciation and amortisation of deferred credits were allocated using the same proportion.

Amortisation of deferred credits

A line was added to the template in order to allow us to show current cost depreciation consistently with the report in table A7 and this allows the totals to be consistent, whilst also protecting the integrity of the total line in this table.

Accounting separation trial 2014/15

	Water resources £000	Raw water distribution £000	Water treatment £000	Treated water distribution £000
Operating expenditure	3,255	5,808	35,443	54,822
Infrastructure renewals charge	-	1,500	-	34,592
Current cost depreciation	17,404	614	19,070	11,960
Amortisation of deferred credit	(151)	(151)	(151)	-
Total operating costs	20,508	7,771	54,362	101,374

	Water resources		Raw water distribution		Water treatment £000	Treated water distribution	
	Abstraction licence £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000		Trunk treated water distribution £000	Local treated water distribution £000
Operating expenditure	(1,231)	4,486	5,770	38	35,443	811	54,011
Infrastructure renewals charge	-	-	1,500	-	-	18,614	15,978
Current cost depreciation	-	17,404	-	614	19,070	6,436	5,524
Amortisation of deferred credit	-	(151)	(151)	-	(151)	-	-
Total operating costs	(1,231)	21,739	7,119	652	54,362	25,861	75,513
Volumes/ drivers	Water abstracted (£/MI)	Water abstracted (£/MI)	Raw water mains (£/km)	Raw water capacity (£/MI)	Water into supply (£/MI)	Water into supply (£/MI)	Water into supply (£/MI)
Unit costs:	-4 ¹	65	36,064	597	166	79	230

¹ The negative unit cost results from reimbursement of £3,840,000 Environmental Improvement Unit Charges ('EIUC') levied from 2008/09 to 2012/13 and £1,732,000 of credit notes received from the Environment Agency in respect of EIUC levied in 2013/14.

Abstraction licence and Raw water abstraction:

For Water resources we have chosen the amount of water abstracted (MI) as the most relevant cost driver.

Raw water transport:

For raw water transport, we have chosen the length of raw water main as the cost driver. Raw water mains are different to treated water mains as they are not subject to the same constraints of pressure and quality considerations.

Raw water storage:

Raw water storage costs are dominated by depreciation (CCD). We therefore take the view that the primary cost driver is the size of the asset for which we have used storage capacity as a proxy.

Water treatment:

Water treatment costs are dominated by operational costs and the volume of water treated (water into supply) is clearly the primary cost driver.

Treated water distribution:

For treated water mains we believe that water into supply is the primary cost driver, rather than mains length. As we described in our submission to Ofwat in September 2013, the primary cause of damage to mains is the pressure fluctuations that result from various taps and appliances being switched on and off, and the best proxy for this is water into supply. This applies to both distribution and trunk mains.

Appendix I

Cost Centre Allocations

Water Resources

Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21142	COS - Reg - Production - Karstic Sites
21152	COS - Reg - Production - Surface Works Maintenance
21161	COS - Reg - Production – Control
21195	COS - Reg - Asset Delivery
21196	COS - Reg - CIAM Asset Delivery
21212	COS - Reg - Community Operations - Operational Contact Centre - Gen.- SEast
21301	COS - Reg - Asset Management - General
21303	COS - Reg - Asset Management - General - East

Raw Water Distribution

Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
21135	COS - Reg - Production - Supply - General - SEast
21142	COS - Reg - Production - Karstic Sites
21152	COS - Reg - Production - Surface Works Maintenance
21161	COS - Reg - Production - Control
21171	COS - Reg - Production - Engineering Support
21181	COS - Reg - Production - Supply Management
21191	COS - Reg - Production - Energy
21212	COS - Reg - Community Operations - Operational Contact Centre - Gen.- SEast
23502	COS - Administrative - Compliance & Regulation
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops

Water Treatment

Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
21135	COS - Reg - Production - Supply - General - SEast
21142	COS - Reg - Production - Karstic Sites
21152	COS - Reg - Production - Surface Works Maintenance
21161	COS - Reg - Production - Control
21171	COS - Reg - Production - Engineering Support
21181	COS - Reg - Production - Supply Management
21191	COS - Reg - Production - Energy
21195	COS - Reg - Asset Delivery
21196	COS - Reg - CIAM Asset Delivery
21212	COS - Reg - Community Operations - Operational Contact Centre - Gen.- SEast

21301	COS - Reg - Asset Management - General
21303	COS - Reg - Asset Management - General - East
23502	COS - Administrative - Compliance & Regulation
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
40220	G&A Expenses - Finance - General Management

Treated Water Distribution

Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
21135	COS - Reg - Production - Supply - General - SEast
21142	COS - Reg - Production - Karstic Sites
21152	COS - Reg - Production - Surface Works Maintenance
21161	COS - Reg - Production - Control
21171	COS - Reg - Production - Engineering Support
21181	COS - Reg - Production - Supply Management
21191	COS - Reg - Production - Energy
21195	COS - Reg - Asset Delivery
21196	COS - Reg - CIAM Asset Delivery
21212	COS - Reg - Community Operations - Operational Contact Centre - Gen.- SEast
21213	COS - Reg - Community Operations - Operational Contact Centre - Gen.- East
21223	COS - Reg - Network - Maintenance - General - SEast
21225	COS - Reg - Network - Maintenance - General - East
21241	COS - Reg - Community Operations - Network - Management & Contracts
21242	COS - Reg - Community Operations - Network - Direct Labour Force
21243	COS - Reg - Community Operations - Network - Streetworks
21244	COS - Reg - Community Operations - Network - Fixed Overhead Recharge - Finance
21245	COS - Reg - Community Operations - Adhocs
21254	COS - Reg - Community Operations - South Rechargeables
21301	COS - Reg - Asset Management – General
21302	COS - Reg - Asset Management - General – Seast
21303	COS - Reg - Asset Management - General – East
21471	COS - REG - Community Operations - South Customer Operations
21472	COS - REG - Community Operations - East Customer Operations
21473	COS - REG - Community Operations - West Customer Operations
21474	COS - Reg - Community Operations - South Rechargeables
21475	COS - Reg - Community Operations - Contractor Rechargeables
23502	COS - Administrative - Compliance & Regulation
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
40961	G&A EXPENSES - Community Operations - Direct Labour Force Recharges

Retail

Cost Centres	Cost Centre Description
21211	COS - Reg - Network - Operational Contact Centre - Gen.
21411	COS - Reg - Customer - Contact Centre – General
21421	COS - Reg - Customer - Meter Reading
21422	COS - Reg - Customer - Debt Collection
21431	COS - Reg - Customer Relations - Income Services
21451	COS - REG - Customer Relations - Customer Relations Management
21452	COS - REG - Customer Relations - Special Care Team
21453	COS - REG - Customer Relations - Directors Office
21454	COS - REG - Customer Relations - Customer Services
21455	COS - REG - Customer Relations - Chargeable Control
21456	COS - REG - Customer Relations - CE Planning
21457	COS - REG - Customer Relations - Meter Installation
21458	COS - REG - Customer Relations - Billing Services
21459	Voice of the Customer
21460	COS - REG - Customer Relations - Commercial Services Cost
21461	COS - REG - Customer Relations - Commercial Services
40204	G&A Expenses - Account Processing - Receivables
40205	G&A Expenses - Account Processing - Customer Payments

