



# Methodology Statement for Accounting Separation 2015/16

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Affinity Water Limited

June 2016

## Table of Contents

	<b>Page</b>
1 – Introduction	1
2 – System and Structures	6
3 – Operating Expenditure Allocation Assumptions	7
4 – Billing and Collection	21
5 – Capital Expenditure	23
6 – Revenue	25
 <b>APPENDICES</b>	
Appendix I      Cost Centre Allocations	26

# 1 – Introduction

## 1.1 Purpose

The purpose of this document is to set out our approach on accounting separation. Ofwat requires 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). However within this document we do explain how we calculate and remove any non appointed business activity to only leave the appointed business.

## 1.3 Overview

Each company is required to present detailed revenue and cost information for different parts of their appointed business for which Ofwat sets the price controls for 2015-2020.

This document should be read in conjunction with Ofwat’s guidelines on accounting separation (RAG 2.05 and 4.05) and regulatory tables published in our accounts.

## 1.4 Significant Changes Year on Year

### Total Operating Cost

As Ofwat no longer requires companies to produce a complete set of current cost accounting (CCA) financial information, the below year on year comparison excludes any movements in Capital Maintenance.

2015/16 is the first year of the company’s adoption of Financial Reporting Standard (FRS) 101. As a result, the capital maintenance figures have been calculated based on historical cost accounting and not current cost accounting as per the prior year. The prior year comparatives included below have not been restated under FRS 101.

Operating Cost	2014/15	2015/16	Movement
Wholesale	£99.33m	£150.81m	+£51.48m
Retail Household	£29.13m	£31.26m	+£2.13m
Retail Non-household	£4.02m	£3.96m	-£0.06m
<b>Total</b>	<b>£132.48m</b>	<b>£186.03m</b>	<b>+£53.55m</b>

Wholesale operating cost has increased by £51.48m compared to the prior year. The increase can be explained by:-

- £2.74m increase in Power due to higher average unit cost per kWh and increased kWh consumption;
- £5.10m increase in Service Charge (abstraction licenses) due to the one-off prior year reimbursement of Environmental Improvement Unit Charges from 2008 to 2014;
- £3.01m increase in Bulk Import (Grafham import) costs due to the first year adoption of FRS 101 – in the prior year interest cost and principal repayment were not allocated to operating cost;
- £40.21m increase in Other Operating Expenditure mainly driven by an increase in:-
  - Infrastructure Renewal Expenditure due to the first year adoption of FRS 101, previously capitalised on the balance sheet;
  - New Connection costs due to the first year adoption of FRS 101, previously capitalised on the balance sheet;
  - IT costs due to one-off costs relating to the Service Delivery Simplification program and Infrastructure Simplification program;
  - Staff costs cost due to higher levels of FTE and lower recharges to capital projects;
- £0.27m increase in Local Authority Rates; and
- £0.15m increase in Third Party Costs.

Retail household operating cost has increased by £2.13m compared to the prior year. The increase can be explained by:-

- £0.80m increase in Customer Services mainly driven by an increase in the volume of network customer queries and complaints by household customers and an increase in cost to serve vulnerable customers;
- £1.04m increase in Debt Management due to the treatment of income from £50 levies charged to customers. In prior years our costs were net of income we received from customers who are charged a £50 levy when their debt is passed on to a second placement debt collection agency. To improve transparency, this year we have included income of £1.03m within Other Operating Income;
- £0.37m decrease in Meter Reading cost mainly driven by our allocation between household and non-household customers. In 2014/15 Meter Reading was allocated based on the number of meters read. As an improvement this year, we have allocated the cost by estimating the additional time or effort a meter reader spends on reading non-household meters under our outsourced contract with Mouchel. We have also identified internal meter readers that are dedicated to reading non-household meters that have therefore been directly allocated. The remaining cost is then allocated based on the number of meters read between the two retail business units;
- £0.05m decrease in Doubtful Debts and Other Operating Expenditure; and
- £0.71m of Depreciation.

Retail non-household operating cost has decreased by £0.06m compared to the prior year. The increase can be explained by:-

- £0.47m decrease in Customer Services mainly driven by a decrease in the volume of network customer queries and complaints by non-household customers;
- £0.32m increase in Debt Management due to the treatment of income from £50 levies charged to customers. In prior years our costs were net of income we received from customers who are charged a £50 levy when their debt is passed on to a second placement debt collection agency. To improve transparency, this year we have included income of £0.32m within Other Operating Income;
- £0.57m decrease in Doubtful Debt due to the decline in the level of uncollectable debt;
- £0.16m increase in Meter Reading cost mainly driven by our allocation between household and non-household customers. In 2014/15 Meter Reading was allocated based on the number of meters read. As an improvement this year, we have allocated the cost by estimating the additional time or effort a meter reader spends on reading non-household meters under our outsourced contract with Mouchel. We have also identified internal meter readers that are dedicated to reading non-household meters and that have therefore been directly allocated. The remaining cost is then allocated based on the number of meters read between the two retail business units;
- £0.53m increase in Service to Developers. In 2014/15 we showed no costs within our retail non-household business unit for service to developers as all costs were fully recharged to developers and netted off against the cost itself. To improve transparency this year, we have included income of £0.53m within Other Operating Income, with related costs shown separately in the retail tables; and
- £0.03 decrease in Other Operating Expenditure.

## Methodology

Improvements have been made to certain allocations to ensure we are fully compliant with Ofwat's new AMP6 guidelines on Accounting Separation. See below for a list of improvements made this year:-

1. Scientific Services income – In 2014/15 our costs were net of any income we received from services provided to external parties. To improve transparency we have included income of £0.3m within Other Operating Income this year.
2. Local Authority Rates – In 2014/15 rates were allocated based on GMEAV splits between business units. This year RAG 2.05 requires rates to be allocated by floor space or FTEs. We have allocated cumulo rates based on an assumption of rateable value attributed to the retail business unit. We believe this best reflects the amount of floor space within the retail business unit.
3. Doubtful Debts – In 2014/15 any non water debt was part of our general and support allocation. This year as an improvement and in accordance with RAG 2.05 any non water debt (e.g. third party, Fire Hydrants etc.) is directly attributed to wholesale or retail depending on the nature of cost.
4. Executive and Non Executive Directors Remuneration – This year RAG 2.05 requires executive and non executive directors remuneration to be allocated by time or management estimate. We have allocated this cost based on the split of our total revenue (within the price control) as we feel this best determines the time spend by our executive and non executive team.
5. Retail Cost Allocation between household and non-household:-
  - a. General and Support Cost – In 2014/15 general and support costs were first allocated to each activity (e.g. Billing, Payment Handling, Meter Reading etc.) based on FTEs and then allocated between household and non-household depending on each activity's allocation. This year in accordance with RAG 2.05 we have allocated all general and support costs by FTE where costs cannot be directly allocated.
  - b. Non-Network Customer Queries and Complaints – In 2014/15 we allocated this cost based on volume of contact on all queries and complaints by household or non-household customers. As an improvement this year, we have allocated the cost based on the time spent dealing with queries and complaints for each customer type.
  - c. Debt Management Income – In 2014/15 our costs were net of income we received from customers who are charged a £50 levy when their debt is passed on to a second placement debt collection agency. To improve transparency, this year we have included income of £1.36m within Other Operating Income.
  - d. Local Authority Rates – In 2014/15 rates were allocated based on customer numbers in the household and non-household business units. This year RAG 2.05 requires rates to be allocated by floor space, FTEs or customer numbers. We have allocated rates by FTEs as

we are not able to calculate the amount of floor space occupied by each retail business unit.

- e. Meter Reading – In 2014/15 meter reading was allocated based on the number of meters read. As an improvement this year, we have allocated the cost by estimating the additional time or effort a meter reader spends on reading non-household meters under our outsourced contract with Mouchel. We have also identified internal meter readers that are dedicated to reading non-household meters and that have therefore been directly allocated. The remaining cost is then allocated based on the number of meters read between the two retail business units.
- f. Service to Developers – In 2014/15 we showed no costs within our retail non-household business unit for service to developers as all costs are fully recharged to developers and netted off against the cost itself. To improve transparency this year, we have included income of £0.53m within Other Operating Income, with related costs shown separately in the retail tables.

## 2 – System and Structures

### 2.1 System

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

### 2.2 Structures

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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

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The core data is taken from the year end Trial Balance (TB) and 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 4.05 – Water Resources-Abstraction Licence, Water Resources-Raw Water Abstraction, Raw Water Distribution-Raw Water Transport, Raw Water Distribution-Raw Water Storage, 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 Removable of Non Appointed Cost

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Before each line is individually allocated to a business unit, non appointed costs are deducted from the TB to leave only appointed costs.

Non appointed costs are calculated within a separate model using various assumptions. Our two non appointed activities are:-

1. Sewerage billing, cash collection and infrastructure commission
2. Unregulated income (value added services)

#### **Sewerage billing, cash collection and infrastructure commission**

The main costs associated with sewerage commission are:-

Staff costs within our debt collection team and other support teams. We assume our debt collection team spends the same proportion of time allocated to sewerage as an average customer's total water and sewerage bill. Our support teams who process weekly payments and provide other analysis keep a record of the time they have spent on sewerage activities. This percentage is then applied to the relevant employment cost.

Debt collection agency cost. We assume debt collection agency cost is split in the same proportion as an average customer's total water and sewerage bill.

Other smaller costs such as bank fees for cash transfers, Hi Affinity (our billing system) license fees and audit fee are also considered.

#### **Unregulated income (value added services)**

The main cost associated with unregulated income is direct costs and staff costs. We keep a record of the time spent by our staff on non appointed activity and this is allocated accordingly.

#### **General and Support**

We assume an element of general and support costs are also associated with running the non appointed business.

We apportion these costs based on the percentage on non appointed income compared to total income for Affinity Water.

### 3.3 Direct Cost

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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 tables (2B and 4D), where we have to report costs at the following level of detail:

1. Power
2. Income treated as negative expenditure
3. Service charges / discharge consents
4. Bulk supply / Bulk discharge
5. Other Operating Expenditure (Such as Employment, Hired and Contracted, Materials, Associated Companies and Other Direct Cost)
6. 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												
Ref	Type	Basis	Last reviewed	Cost Centres/Detail Code	Water resources		Raw Water Distribution		Water Treatment	Treated Water Distribution	Retail	G&S	Business Rates	Atypical	Regulation	Total
					Abstraction Licenses	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Retail	G&S	Business Rates	Atypical	Regulation	Total
1	BS/Income	NA	Mar-16	00000/11111	0.00%	0.00%	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-16	21191 and lines classified as power costs in other CC's (21127/21212)	0.00%	18.46%	13.59%	0.00%	6.05%	61.90%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
3	Supply	Per Manager	Mar-16	21161/71/81	1.00%	37.00%	1.00%	0.00%	4.00%	57.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
4	EA Charges	OFWAT Guidance	Mar-16	CC 21161 & CC 21212 - 841010 & detail codes 861121,881312,942206	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
5	Imports	OFWAT Guidance	Mar-16	Detail codes designated as "Bulk Water..."	0.00%	0.00%	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-16	various	0.00%	0.00%	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-16	21123	0.00%	0.00%	19.66%	11.96%	46.32%	22.06%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
8	Karstic	Per Manager	Mar-16	21142	0.00%	0.00%	30.00%	0.00%	60.00%	10.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
9	Production Network	Per Manager	Mar-16	21112/27/32/52 21212	0.00%	7.40%	5.40%	0.00%	76.10%	11.10%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
10	Services Customer	Per Manager	Mar-16	21223/25/31/32/41/42/43/45	0.00%	0.00%	2.00%	0.00%	2.00%	96.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
11	Operations	Per Manager	Mar-16	21213/245/251/254/302/4	0.00%	0.00%	2.00%	0.00%	2.00%	96.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
12	Leakage	Per Manager	Mar-16	74/475 40911/961 21471/2/3	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
13	Asset M'ment	Per Manager	Mar-16	21195/96 21301/21303	2.26%	30.00%	0.00%	0.00%	29.03%	38.71%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
14	Water Quality	Per Manager	Mar-16	23502/03/05/06/07/08	0.00%	13.30%	1.40%	0.20%	33.10%	52.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%
15	Rates	Rateable Value 1/5 per OFWAT Guidance	Mar-16	xxxx-942204	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	100.00%
16	Regulation		Mar-16	21485	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	100.00%
17	Retail		Mar-16	21211/21411/21421/22/51/52/53/54/55/56/57/58/59/	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	0.00%	100.00%
18	Overheads		Mar-16	60/61 40204/05/07 various	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	0.00%	0.00%	0.00%	100.00%

### 3.4 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 three expense categories that require proportional allocation across the business units. These are:

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

#### General and Support

We have six main cost types within General and Support totaling £25.32m. These costs are allocated amongst the seven 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	Total Cost (£m)
Human Resources	Number of FTEs	1.91
Head Office Facilities Management and Property Rent	Floor space of Head Office	2.89
Procurement	Current year's hired & contracted, material cost and other smaller values general ledger codes deemed to influenced by the activities of the procurement department.	0.59
Information Technology	<ol style="list-style-type: none"> <li>1. Direct allocation of key systems</li> <li>2. Number of FTEs for remaining cost (assuming each FTE has one device).</li> </ol>	7.50
Legal and Insurance	<ol style="list-style-type: none"> <li>1. Management estimate on insurance premium and claim history</li> <li>2. Number of FTEs for remaining cost</li> </ol>	4.16
Other: Finance, General Management, Corporate Services, Health and Safety and External Communication.	Number of FTEs	8.27

#### 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 original business units; water resources, raw water distribution, water treatment, treated water distributed and retail.

Within water resource and raw water distribution this cost has been further split evenly across the additional business units.

## Local Authority Rates

Cumulo Rates are allocated based on an assumption of rateable value attributed to the wholesale and retail business units.

Head office building rates are allocated on the floor space of head office.

## 3.5 Operating Cost Analysis for Wholesale Business

The table below shows how costs are allocated to each line in tables 2A, 2B and 4D.

### Allocation to cost driver

Table Line	Activity / Cost Type	Cost Driver	Allocation to Business Unit (BU)
Power	Power	Direct allocation by use of specific expenditure codes and cost centres.	Aggregated Average Pumping Head data for each BU.
Income treated as negative expenditure	Power	Direct allocation by use of specific expenditure codes and cost centers.	Aggregated Average Pumping Head data for each BU.
Service Charges	Abstraction Charge	Actual charges from the Environment Agency allocated to wholesale.	Direct allocation to Water Resources – Abstraction Licenses by use of specific expenditure codes and cost centres.
Bulk Supply Imports	Bulk Supply Import	Direct allocation 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	<b><u>Direct cost</u></b> 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 management estimate.

Table Line	Activity / Cost Type	Cost Driver	Allocation to Business Unit (BU)
	<p><b><u>Indirect Cost</u></b></p> <p>Executive and non executive directors remuneration</p> <p>General and Support (including Doubtful Debt)</p> <p>Scientific Services</p> <p>Other Business Activity</p>	<p>Costs indirectly allocated to wholesale.</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>Executive and non executive director costs have been allocated based on our total revenue split (within the price control). We feel this best determines the time spend by the team as detailed timesheets are not maintained.</p> <p>General &amp; Support costs are applied pro-rata to direct employees within each business unit, direct allocation or split based on management estimates. (See Section 3.3 for detail)</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 across the seven business units.</p>
Local Authority Rates	Local Authority Rates	<p>Actual charge from local Authority.</p> <p>Cumulo Rates allocation based on rateable value attributed to wholesale.</p>	<p>Cumulo Rates are allocated to each BU based on GMEAVs.</p> <p>Head Office Building Rates are allocated based on floor space.</p>
Third Party Services	Total cost relating to serving Third Party Services	Direct allocation by use of specific expenditure codes and cost centres.	<p>Non-potable water – all in raw water distribution.</p> <p>Rechargeable works – all in treated water distribution.</p>

Table Line	Activity / Cost Type	Cost Driver	Allocation to Business Unit (BU)
			Special agreements – separately calculated to reflect management estimates of resources consumed to deliver the BU.

## 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	Total (£m)	Nature of Cost
Vehicles	2.63	Cost for vehicle leasing and maintenance
Telephones	0.39	Cost for mobile telephones
Street Works	1.68	Cost of permits, fines/fees and consequential damage to highway
Bad Debt	0.22	Bad debt relating to wholesale non water debt
Water Efficiency Audit Cost	0.76	Cost of carrying out water audits on customer properties as a part of the Water Saving Program
Other	0.62	Other small items
<b>Total</b>	<b>6.30</b>	

## Cash expenditure

In table 4D we distributed the pension deficit recovery payment using the apportionment of how International Accounting Standard (IAS) 19 pension service cost is allocated across cost centres within the wholesale business units.

## Unit Cost Information

In table 4D we are required to submit volumes (ML) for each wholesale business unit.

- For Water Resources – Abstraction Licences we have used licences for water (ML) available to us. This gives a unit cost of £10.55/ML;
- For Water Resources – Raw Water Abstracted we have used volume of water (ML) abstracted. This gives a unit cost of £30.17/ML;

- For Raw Water Distributed – Raw Water Transported we have used volume of water transported. This gives a unit cost of £104.76/ML;
- For Raw Water Distributed – Raw Water Storage we have no volume of water that is in storage. We do however have dormant asset (reservoirs) which need to be maintained due to the requirement from various regulatory bodies;
- For Water Treatment we use distributed input water volumes (ML). This gives a unit cost of £79.62/ML;
- For Treated Water Distribution we use distributed input water volumes (ML). This gives a unit cost of £312.68/ML.

### 3.6 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 2.05.

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, then household split into unmeasured and measured. 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 2A and 2C between household and non-household.

#### 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 of 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.

Table Line	Activity/ Cost Type	Cost Driver	Rationale for cost driver
			We have no cost in 2015/16.
	Vulnerable customer schemes	All household.	Actual charge is wholly attributable to household customers only.
	Non-network customer queries and complaints	Time spent on all queries and complaints for household / non-household customers.	Cost of dealing with queries and complaints is assumed to be directly linked to the amount of time spent on each customer type.
	Network customer queries and complaints	Volume of contact based on all enquires and complaints by household / non-household customers.	Our contact centre does not record time spent on each type of customer, therefore we have assumed costs vary in proportion to the number of operational contacts made by customers.
	Investigatory visits / first visits to the customer	Volume of contact based all enquires and complaints by household / non-household customers.	Our customer service technicians do not record time spent on each type of customer, therefore we have assumed 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.	Directly allocated based on the team dealing with customer type.
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	Estimate of additional time / effort spent on reading meters for non-household customers	We have estimated the additional time / effort a meter reader spends on reading non-household meters under our outsourced contract with Mouchel.  We have also identified internal meter readers

Table Line	Activity/ Cost Type	Cost Driver	Rationale for cost driver
		<p>Non-household internal meter readers</p> <p>Number of meter reads for household / non-household.</p>	<p>that are dedicated to reading non-household meters and therefore are directly allocated.</p> <p>The remaining cost is then allocated based on number of meters read between the two retail business units.</p>
Services To Developers	Services To Developers	All non-household.	Actual charge is wholly attributable to non-household customers only.
Other Operating Expenditure	Disconnections	All non-household.	Number of disconnections 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.	Directly allocated. Where this is not possible we have used the number of customers as we do not maintain timesheets for such costs.
	Executive and non executive directors remuneration	Total Revenue within the price control.	Executive and non executive director costs have been allocated based on our total revenue split (within the price control). We feel this best determines the time spend by the team as detailed timesheets are not maintained.
	General & Support	Cost allocated between household and non-household customers based on FTE.	Our teams within the general and support functions do not keep timesheets, therefore we assume the costs vary depending on FTEs.
	Other Business Activities	Number of customers.	Assumed allocation between household and non-household will follow

Table Line	Activity/ Cost Type	Cost Driver	Rationale for cost driver
			the same proportion as customer numbers.
Local Authority Rates	Cumulo Rates  Head Office Building Rates	Number of FTEs.	As we are not able to obtain floor space we have allocated based on FTE.
Third Party Services	Third Party Services	Direct allocation.	Dependent on service provided.

## Retail Other Direct Cost

The table below provides a breakdown of cost categories and values that we have included in Other Direct Cost.

Cost Centre Description	Total (£m)	Nature of Cost
Income Services	0.43	Employment and third party commission costs associated with delivering additional income through missing proprieties and voids.
Customer Services Management	1.41	Employment cost of Customer Service Management team.
Directors' Office	0.17	Employment costs for dealing with written complaints and awarding both statutory and ex-gratia compensation payments for breaching service standards.
Customer Experience Planning	0.45	Employment costs of delivering Customer Service systems enhancements and upgrade, coaching team, and resource & planning team.
Voice Of The Customer	0.23	Employment costs for administering customer feedback systems.
Commercial Services Admin	0.64	Employment costs for administration and retention / acquisition of commercial customers for appointed income streams.
<b>Total Other Direct Cost</b>	<b>3.33</b>	

The table below shows how costs are allocated to each line in table 4F between household unmeasured and measured.

## Allocation to cost driver between household unmeasured and measured

Table Line	Activity / Cost Type	Cost Driver	Rationale for cost driver
Customer Services	Billing	Number of household unmeasured and measured bills raised.	The cost for billing activity is directly linked to the number of bills raised. The number of bills is based on assumptions of the annual billing cycles for unmeasured and measured customers.
	Payment handling, remittance and cash	Number of household unmeasured and measured receipts.	Costs for payment handling is assumed to be directly linked to type of receipt processed.

Table Line	Activity / Cost Type	Cost Driver	Rationale for cost driver
	Charitable trust donations	Number of household unmeasured and measured customers.	We have no cost in 2015/16.
	Vulnerable customer schemes	Number of household unmeasured and measured customers on our Low Income Tariff (LIFT)	Cost of dealing with vulnerable customers can be linked to our larger vulnerable customers who are on the LIFT tariff.
	Non-network customer queries and complaints	Volume of contact based on all enquires and complaints by household unmeasured and measured customers.	Costs vary in proportion to the number of contacts made by customer type.
	Network customer queries and complaints	Volume of contact based on all enquires and complaints by household unmeasured and measured customers.	Costs vary in proportion to the number of contacts made by customer type.
	Investigatory visits / first visits to the customer	Volume of contact based on all enquires and complaints by household unmeasured and measured customers.	Costs vary in proportion to the number of contacts made by customer type.
Debt Management	Debt Management	Debt outstanding for more than 30 days by household unmeasured and measured customers.	Costs assumed to vary with the proportion of debt outstanding for more than 30 days for each customer type.
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 unmeasured and measured customers.
Meter Reading	Meter Reading	All household measured.	Actual charge is wholly attributable to household measured customers only.
Other Operating Expenditure	Demand Side Water Efficiency Initiatives	Number of household unmeasured and measured customers.	We are unable to allocate directly therefore it has been assumed that costs vary with customer

Table Line	Activity / Cost Type	Cost Driver	Rationale for cost driver
	Customer Side Leaks Other Direct Costs Executive and non executive directors remuneration General & Support Other Business Activities		numbers.
Local Authority Rates	Cumulo Rates Head Office Building Rates	Number of household unmeasured and measured customers.	We are unable to allocate directly therefore it has been assumed that costs vary with customer numbers.

## 4 – Billing and Collection

### 4.1 Outsourced Activities

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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:-

- 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.
  - 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.
  - 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

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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 to recognise that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the bulk owner 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.

Affinity Water 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 is amended, the customer’s name applied to the account and billing commences. 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 is then issued in the name of ‘The Occupier’. This only occurs for measured customers.

In each of the above cases, if a bill is sent, Affinity Water will recognise it within revenue 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 revenue. 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

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At each reporting date, the company evaluates the collectability of trade receivables and records a provision for impairment based on experience. The provision for impairment is charged to operating costs to reflect the company's assessment of the risk of non-recovery of trade receivables. The provision for impairment is calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of receivable. Higher percentages are applied to those categories of receivable which are considered to be of greater risk and also to trade receivables of greater age. The value of the provision for impairment 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 trade receivables 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 Expenditure

### 5.1 Key Principles

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Expenditure is recorded at a project level with each project being individually and specifically allocated to the relevant accounting separation category.

Where more than one business unit utilises an asset, it is allocated on the basis of principal use. A cross charge is then made to the other business units.

As a consequence, when completing table 4D we have followed the process as detailed below.

Maintaining the long term capability of the assets – infra: Infrastructure Renewals Expenditure (“IRE”) is allocated based on principal use. In the case of IRE expenditure, it is allocated between two business units within wholesale – Raw Water Distribution and Treated Water Distribution based on the assignment of the individual project.

Expenditure is also allocated across the following categories based on the assignment of the individual project.

- I. Maintaining the long term capability of the assets – non infr,
- II. Other Capital Expenditure Infra,
- III. Other Capital Expenditure – non infra

#### **Exceptions:**

There are a number of projects that are set up to collect costs of a “general” nature such as overhead support costs etc. These are exceptions to the principal use approach as no single business unit has principal use.

These are therefore allocated “pro-rata” across the different business units based on the totals of directly allocated expenditure.

#### **Third Party Services:**

We own assets that are utilised in providing water to our third party customer, South East Water. This expenditure is allocated across the categories in exactly the same way as our investments in other assets.

#### **Grants and Contributions:**

Grants and Contributions are generally only received in relation to Treated Water Distribution. Receipts are analysed for any exceptions to this rule.

#### **Other tables**

When completing table 2A, the segmental income statement, we have again used principal use as the basis of cross charging between the business units.

When completing table 2C, the operating cost analysis – retail, we have recognised that the principal use of our retail investments has been within the household business. Our non-household business has yet to invest independently. Furthermore when completing table 4F, the operating cost analysis – household retail, we have used the proportion of unmeasured and measured customers to split Depreciation.

Table 2D (Historic cost analysis of fixed assets – wholesale & retail) shows brought forward figures based on principal use. This again reflects the fact that the non-household retail business (in its infancy) holds no investments of its own. Wholesale additions (in total) match those further broken down in table 4D.

**Current Cost Depreciation (“CCD”)**

Table 4G uses the CCD figure brought forward from the previous year’s Regulatory Accounts, amended by RPI and CCD on new wholesale additions to calculate the new CCD figure.

## 6 – Revenue

### 6.1 Key Principles

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As per Ofwat guidelines (RAG 4.05) revenue is categorised as follows:-

1. Appointed revenue included in price control
  - Wholesale
  - Retail Household
  - Retail Non-household
2. Third party revenue – non-price control
3. Non appointed revenue

### 6.2 Approach Taken

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#### **Appointed revenue included in the price control**

This includes wholesale and retail tariff income from water.

Our Hi Affinity billing system does not allow us to view a breakdown of household and non-household revenue by wholesale and retail charges. We therefore extract the total billed value by tariff for household and non-household customers from Hi Affinity and use the Charging Scheme 2015/16 (submitted to Ofwat) to apportion the revenue between wholesale and retail charges.

#### **Third party revenue – non-price control**

This includes Bulk Supplies and Rechargeable work. This is directly allocated to wholesale appointed revenue.

#### **Non appointed revenue**

This includes Sewerage billing, cash collection and infrastructure commission and unregulated income (value added services). This is directly allocated to non appointed revenue.

# Appendix I

## Cost Centre Allocations

Water Resources - Abstraction Licences
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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
21171	COS - Reg - Production - Engineering Support
21181	COS - Reg - Production - Supply Management
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
21485	COS - REG - Regulation

Water Resources - Raw water abstraction
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Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21125	COS - Reg - Production - Treatment - General - S
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
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
23502	COS - Administrative - Compliance & Regulation
23503	COS - Administrative - AQC
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
23507	COS - Administrative - Chemistry
23508	COS - Administrative - SCRS - Strategy & Customer Liaison
21485	COS - REG - Regulation

Raw Water Distribution - Raw water transport
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Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21125	COS - Reg - Production - Treatment - General - S
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
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
21211	COS - Reg - Network - Operational Contact Centre - Gen.
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
21251	COS - Reg - Community Operations - Asset Management - Leakage Support
21252	COS - Reg - Community Operations - Asset Management - Leakage Operations
21254	COS - Reg - Community Operations - South Rechargeables
21302	COS - Reg - Asset Management - General - SEast
21474	COS - Reg - Community Operations - South Rechargeables
21475	COS - Reg - Community Operations - Contractor Rechargeables
21476	Community Operations – New Connections
40961	G&A EXPENSES - Community Operations - Direct Labour Force Recharges
23502	COS - Administrative - Compliance & Regulation
23503	COS - Administrative - AQC
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
23507	COS - Administrative - Chemistry
23508	COS - Administrative - SCRS - Strategy & Customer Liaison
21485	COS - REG - Regulation

Raw Water Distribution - Raw water storage
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Cost Centres	Cost Centre Description
21123	COS - Reg - Production - Estates
23502	COS - Administrative - Compliance & Regulation
23503	COS - Administrative - AQC
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
23507	COS - Administrative - Chemistry
23508	COS - Administrative - SCRS - Strategy & Customer Liaison
21485	COS - REG - Regulation

Water treatment
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Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21125	COS - Reg - Production - Treatment - General - S
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
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
21211	COS - Reg - Network - Operational Contact Centre - Gen.
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
21251	COS - Reg - Community Operations - Asset Management - Leakage Support
21252	COS - Reg - Community Operations - Asset Management - Leakage Operations
21254	COS - Reg - Community Operations - South Rechargeables
21301	COS - Reg - Asset Management - General
21302	COS - Reg - Asset Management - General - SEast
21474	COS - Reg - Community Operations - South Rechargeables
21475	COS - Reg - Community Operations - Contractor Rechargeables
21476	Community Operations – New Connections
40961	G&A EXPENSES - Community Operations - Direct Labour Force Recharges
23502	COS - Administrative - Compliance & Regulation
23503	COS - Administrative - AQC
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
23507	COS - Administrative - Chemistry
23508	COS - Administrative - SCRS - Strategy & Customer Liaison
21485	COS - REG - Regulation

Treated Water Distribution
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Cost Centres	Cost Centre Description
21112	COS - Reg - Production -Small Sites
21123	COS - Reg - Production - Estates
21125	COS - Reg - Production - Treatment - General - S
21127	COS - Reg - Production - Treatment - General - East
21132	COS - Reg - Production - Technical Services
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
21211	COS - Reg - Network - Operational Contact Centre - Gen.
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
21251	COS - Reg - Community Operations - Asset Management - Leakage Support
21252	COS - Reg - Community Operations - Asset Management - Leakage Operations
21254	COS - Reg - Community Operations - South Rechargeables
21301	COS - Reg - Asset Management - General
21302	COS - Reg - Asset Management - General - SEast
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
21476	Community Operations – New Connections
40961	G&A EXPENSES - Community Operations - Direct Labour Force Recharges
23502	COS - Administrative - Compliance & Regulation
23503	COS - Administrative - AQC
23505	COS - Administrative - Network Regulations
23506	COS - Administrative - Lab Ops
23507	COS - Administrative - Chemistry
23508	COS - Administrative - SCRS - Strategy & Customer Liaison
21485	COS - REG - Regulation

Retail
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Cost Centres	Cost Centre Description
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
40205	G&A Expenses - Account Processing - Customer Payments

General and Support
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Cost Centres	Cost Centre Description
21481	COS - REG - Finance - Accounts Management
21482	COS - REG - Finance - General Management
21484	COS - REG - Finance - Rechargeables
23302	COS - Administrative - Insurance - General
23303	COS - Administrative - Legal, Land Sale Cost
23401	COS - Administrative - Procurement - General
23402	COS - Purchase Order Support - General
23501	COS - Administrative - Health and Safety
23504	COS - Administrative - Education Support
23603	COS - Administrative - IT CIO
23604	COS - Administrative - IT BRM
23605	COS - Administrative - IT Application Delivery
23606	COS - Administrative - IT PMO
23611	COS - Administrative - IT Infrastructure
23612	COS - Administrative - IT Services Management
23614	COS - Administrative - IT - Asset Information
23702	COS - Administrative - Facilities Man. - SEast
23802	COS - Administrative - HR - Graduates
23803	COS - Administrative - HR - Recruitment
40102	G&A - General Management - General - South East
40201	G&A Expenses - Finance - General
40209	G&A Expenses - Finance - Corporate
40218	G&A Expenses - Finance - Accounts Management
40219	G&A Expenses - Finance - Chairman
40220	G&A Expenses - Finance - General Management
40221	G&A Expenses - Finance - Group Services
40222	Corporate Provisions
40223	G&A Expenses - Finance - Organisational Development
40301	G&A Expenses - Legal, Insurance, Audit – General
40302	G&A Expenses - Legal
40304	G&A Expenses - Internal Audit
40401	G&A Expenses - Procurement
40505	G&A Expenses - Health & Safety
40701	G&A Expenses - Facilities Man. - General
40801	G&A Expenses - HR
40803	G&A Expenses - HR - Training
40804	G&A Expenses - HR - Private Health
40805	G&A Expenses - Payroll
40806	G&A Expenses - HR - Organisational Development Change
40901	Corporate Affairs
40902	G&A Expenses - Corporate Communications

