

Report by Martin Blenkharn, Reporter

On Veolia Water Southeast's June Return 2011 Submission

1.0 Summary

We have checked and can confirm the accuracy of the Company's statements within their June Return 2011 Report. These were compared to the information in the June Return tables and the other information seen by us during our audit process.

At each audit we agreed with the Company on which points were material and required reporting by exception. These points are covered in the Appendix of the Company Report and also covered in sections 2.2.1 to 2.2.7 within our report.

We have checked and challenged the Company levels of service information and can confirm that we agree with their data. Our certificate, attached as Annex 2 of this report, confirms that the level of service information has been properly compiled by Veolia Water Southeast.

2.0 Basis of our opinion

Our opinions regarding the Veolia Water Southeast's June Return 2011 are based on the audits we undertook in May and June 2011. A full list of these audits is given in Annex 1. We made a detailed record on the outcome of each audit and these records have been checked for accuracy by the Company before being archived for reference if required at a future date. Our review of the June Return was intended to ensure that the Company has submitted data in accordance with the latest Ofwat Guidance and to report by exception to Ofwat on material issues and changes in methodology and data that we found in the course of our work. Where material issues were identified we have detailed these and explained the approach applied to establishing materiality.

2.1 Outcomes of our checks

At each of our audits, in addition to covering the table specific guidance, we checked the following as requested in the Ofwat Reporters Requirements dated January 2011;

2.1.1 The adequacy of the company's methods and procedures in providing the data that Ofwat is seeking in JR11

We considered that in all cases the Company methods and procedures were adequate. In the majority of cases, these had not materially changed from those used in the previous report year.

2.1.2 That the company had prepared its JR11 data in accordance with its stated methods procedures, policies and assumptions

In our opinion the Company has completed its JR11 dated in accordance with its stated methods procedures, policies and assumptions

2.1.3 That there were coherent links between the current and earlier relevant company submissions and where the links were not coherent we commented

In all cases there were coherent links between this years and earlier relevant Company submissions.

2.1.4 That the methods and procedures were adequate for producing estimates of expenditure needs or records of costs incurred

We consider that all methods and procedures were adequate for producing estimates and records of costs.

2.1.5 That the methods and procedures provided a credible system of quality assurance

A credible system of quality assurance was provided.

2.1.6 That the Company had complied with the process of submissions document or had included a commentary in its overview as to why the guidance had not been followed or why the underlying methodology had changed from the previous year

The Company did in almost all cases comply with the guidance and any difference will be included in sections 2.2.1 to 2.2.7. Similarly there have been a few changes in methodology from the previous year, all improvements, and these again are highlighted in sections 2.2.1 to 2.2.7.

2.1.7 Any material changes to company systems, processes and models which have not been highlighted to Ofwat by the Company and report by exception

There has been no material changes to the Company's systems processes or models that have not been highlighted to Ofwat.

2.1.8 The confidence grades provided by the Company in their tables and comment where we feel the grade is inappropriate

In all cases we considered the confidence grades on the tables as submitted were appropriate.

2.2 Material Issues found during our audits

During our audits we covered all table specific guidance and made a number of challenges against the data and supporting information for each table. From this we identified a number of material exceptions and agreed these with the Company at the time of the audit.

The material exceptions are covered in the Company General Report but we will also include these within this report.

2.2.1 Key Outputs (Tables 1, 2 4, 5 and 6)

There are no exceptions which we considered needed to be included in the Company's General Report or our report for Tables 1, 4, 5 and 6.

Table 2:- There has been a large increase in unplanned interruptions over 6 hours which was primarily due to a single burst which resulted in 2530 properties being affected for 8.5 hours. Without this burst, the figures would have been in line with previous years. Planned interruptions are also similarly much greater than in JR10 due to the increased activity on mains renewals.

2.2.2 Vulnerable Customers (Tables 6b)

There are no exceptions which we considered needed to be included in the Company's General Report or our report for this table.

2.2.3 Non Financial Measures (Tables 7, 8, 10, 10a, 10b, 11, 11a and 12)

There are no exceptions which we considered material in tables 7, 8 10 and 11.

Table 10a:- The Company has used different WAFU values for both the dry year annual average and the critical period from those used in the WRMP. The Company has explained that deployable outputs at several sites have been investigated and tested which has resulted in changes at these sites. The most significant is the St. Margaret's source which has increased under average conditions from 1.13 ML/day to 5.21 ML./day. The Company has no longer counted the 1.33 ML/day bulk import from Southern Water.

Similarly peak outputs have been checked and there has been a slight reduction in this figure when all the sites are taken in to account.

VSE has explained that these amendments have been verified by the Environment Agency.

Table 10b:- Similarly, the WAFU figures in this Table are the same as in Table 10a and again are different from those used in the WRMP for the same reasons as given above.

The Company has not followed the guidelines exactly in this table as outage has been based on the predicted outage in the WRMP not the actual outage as requested in the guidance. The Company explained they did not have the records to report on actual outage.

Table 11a:- The Company, on advice from ourselves, have amended the way they report sources not measured for turbidity. They previously did not count sources that were taken out of supply for more than 28 days. These were not gaps in samples that exceeded 28 days but were operational decisions based on need and cost. In

our view, as long as the number of samples met the criteria, these sources should be reported and this has meant that two extra works are included in line 2 than would otherwise have been the case. Only one works is now not recorded and this was due to the small number of samples.

The number of works has decreased by two as Stonhall and Poulton were not operated in 2010 but were used in 2009.

Table 12:- The Company, again on advice from ourselves, has reviewed the number of sources. This was based on our previous auditing at other water companies where boreholes separate from the main borehole location were counted as distinct sources. This meant that the boreholes had to be on different curtilages and be a reasonable distance from the man site. Veolia Water Southeast had previously counted all boreholes as one source, no matter the geographical location of the boreholes to each other. VSE has therefore re-assessed its sources and this has increased the reported number to 26 from 19. An increase of 3 sources has resulted from an analysis of the Denge boreholes. This previously had been counted as two sources due to the two different treatment processes. However, the individual boreholes are scattered over the Dungeness shingle which is an SSSI and site of special conservation. The Company has to use specialised vehicles to operate the boreholes and can only use specified tracks. We did not consider that every borehole could be considered as a separate source but there were operational hubs that grouped boreholes together. There are 5 hubs in total and these have been reported as such in this Return.

There were also an additional source at Cow Lane that pumps water to Dover Priory and three separate sites that pump water to Rakeshole South (Denton, Tappington North and Rakeshole North). These sources are all in different curtilages and are some distance from the main site.

2.2.4 Current Cost Accounting (Tables 21, 21a/b, 25a/b/c)

There are no exceptions which we considered needed to be included in the Company's General Report or our report for Table 21.

Table 21a/b:- We consider that one exception is worthy of inclusion. Since JR10, VSE are now able to use more appropriate allocations to categories for cost centres which did not fall entirely into one of the defined categories and in particular for the split between household and non household under Retail.

Table 25a/b/c:- There has been an enhanced analysis this year arising from the use of the asset splits established in the Final Business Plan and splitting out other assets more accurately such as telemetry by location and vehicles by driver and then to that individuals cost centre

2.2.5 Expenditure Comparisons by Purpose (Tables 35a and 35b)

There are no exceptions which we considered needed to be included in the Company's General Report or our report for Tables 35a and 35b.

2.2.6 Financial Measures (Tables 32, 33, 34, 35 and 37)

There are no exceptions which we considered needed to be included in respect of Tables 32 and 34.

Table 33:- The Company made two material changes from the previous year, these being the application of the AMP adjustment for the 2009 revaluation and the revised methodology of taking out of the depreciation stream each MNI asset at the end of its life. In previous years the Company assumed that base assets would be replaced at the current gross book value in the year following full depreciation. Following the Ofwat assessment of MEA's and CCD at the Final Determination 2009 the Company decided to calculate future CCD, as given in Table 33, on the basis of what they had included within their Final Business Plan. Therefore it is the Final Business Plan 2009 figures which have been used by VSE as the basis for completing this table. In the Final Determination the projected CCD for 2010/11 was £2.977m, which uplifted for inflation gives a figure of £3.242m. The actual CCD stated in this table is £4.271m. We anticipate that this approximately £1.0m difference will remain throughout AMP 5 with the main cause being the use of the alternative Business Plan figures, rather than those in the Final Determination, by VSE.

Table 35:- The Company is correctly reporting a major contribution of £417 k from a developer, in respect of the IRC Dover scheme, which was completed in a previous year. Therefore VSE had a significant income without any associated expenditure in the report year. Whilst we recognise that expenditure and receipts often do not occur in the same year, since VSE only report contributions on completion of a scheme, in this report year the disparity is particularly marked.

Table 37:- The Company has correctly reported the expenditure, of £358k, on AMP4 SEMD schemes. Any expenditure on AMP5 SEMD work has been correctly allocated to another line.

2.2.7 Greenhouse Gas Accounting (Table 42)

The Company is reporting significantly less electricity use this year compared with JR10. VSE explained that in JR10 they used the higher power factor when determining electricity use as they were unable to confirm from their supplier which was the correct factor to use. For JR11, the supplier has provided an electricity use report and it was evident they had used the lower power factor. This accounts for a reduction of about 8%.

In JR10 a significant amount of test pumping was undertaken which has not been repeated in this year and finally new more efficient pumps have been introduced at a major source and this has reduced electricity use.

Transport emissions have increased due to more use of company vehicles and outsourced usage in scope 3 has increased significantly as the mileage associated with the transporting of water samples from Folkestone to the laboratory in Staines has now been included, 45,000 miles approximately, which was omitted in JR10.

3.0 RAG 5

VSE let one new contract to an associate company in the report year. We consider that the Company has been transparent and fair to all contractors through their award process. Details of the audit we undertook are given in our separate RAG 5 Report.

Date: 16th June 2011

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