Veolia Central Water

JR11 Reporter's Report on the June Return 2011 Submission

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1. Introduction and Key Findings

1.1. General

I am pleased to submit my June Return report as Reporter to Ofwat for Veolia Central Water. For the sections of the Company's submission we have considered, in my view, the Company has submitted a June Return that generally matches the requirements of Ofwat and shows continued improvements from the submissions of previous years.

We have audited Veolia Central Water's June Return 2011, and have commented by exception on the Board Overview within Section 2 of this report. We have also commented by exception on the adequacy of the company's methods and procedures used for each of the June Return tables, as described within Section 3 and Appendix 1 of this report.

1.2. Structure and content of this report

As requested, we have not provided long form commentaries to each of the tables, and our report for JR11 is structured as follows:

Section 2 provides comments on material issues or significant exceptions that relate directly to Veolia Central's Board Overview. It mirrors and responds to the structure of the Board Overview for ease of cross reference. Our comments draw upon the information gathered and opinions formed during our audits of the June Return tables, our liaison with the Company internal auditors, and during meetings with the Board and Internal Audit Committee.

Section 3 provides comments by exception upon each of the tables in the June Return, which take account of the specific requirements set out within Ofwat's Reporting Requirements. This separate commentary by table has been necessary as not all subjects and tables have been covered by the Board Overview. However, we have used cross references where appropriate to avoid repetition or omission of material comments.

Appendix 1 contains a summary of all (including non-material) non-trivial exceptions and issues that we noted during the course of our audits. These are included in tabular form in Appendix 1 which also includes Veolia Central Water's responses or proposed actions in order to provide balance and context.

Annex A contains the General Information, as directed by the Reporter's Reporting Requirements

Annex B contains the Reporter's Level of Service Certificate.

1.3. Reporter process

This is the first year of my appointment as Reporter for Veolia Central. We use a structured approach to the reporting process which allows us to highlight issues or reporting errors to the Company in advance of their submission. This means that most of the material issues identified during our audits have either been resolved prior to submission, or are exposed within the Board Overview, which we believe is the most appropriate and constructive approach to reporting on the June Return. Where Veolia Central has clearly commented on these material issues within its Board Overview and we support these explanations, we may have nothing further to add within this report.

We describe our general approach to auditing within Annex A. In terms of scope, the Reporter is required to *inter alia:*

- *direct Ofwat to the material issues using his expertise and experience*
- *decide on the level of audit that is appropriate for the reporter to be satisfied*
    - *as to the adequacy of the company's methods and procedures in providing the data that Ofwat is seeking in JR11;*

- *that the company has prepared its JR11 data in accordance with its stated methods procedures, policies and assumptions; [Ofwat Reporter's Guidance]*

In order to direct Ofwat to material issues in the following sections, we have concentrated on those areas of disclosure that relate to:

- Figures that represent a failure to meet AMP5 targets, or reporting issues that might mean that AMP5 targets may not have been met;
- Areas of significant non-compliance with the Reporting Requirements;
- Any significant changes to systems, processes, assumptions, data quality and/or confidence grade that have not been disclosed by the Company;
- Material differences in the value, particularly when the change is greater than the confidence grade percentage attributed to it;
- Any adverse or improving trend that could have an effect on the company serviceability assessment;
- Any significant inconsistency with Final Determination or other regulatory reporting, (EA, DWI); and
- Any other circumstances which the Reporter deems to be material or requiring explanation.

Where we have made no comment we are satisfied that there are no material issues or areas of non-compliance with Reporting Requirements or Company procedures, as revealed through our appropriate level of audit. We have noted a number of non-material exceptions within Appendix 1 to this report. These have been included for reference as they illustrate the process of challenge and amendment that has been carried out prior to submission, or relate to non-material points of note for future regulatory reviews or areas of improvement that the Company will consider for future information returns.

1.4. Reporter Key Findings

We have commented upon material issues concerning the Veolia Central June Return 2011 submission in this report. We have carried out audits and have formed the opinion, unless indicated otherwise in the body of this report, its appendices or annexes, that:

- the Company's methods and procedures are adequate for providing the data that Ofwat is seeking in JR11;
- the Company has prepared its JR11 data in accordance with its stated methods procedures, policies and assumptions;
- there are coherent links between the current and earlier relevant Company submissions;
- the methods and procedures are adequate for producing estimates of expenditure needs or records of costs incurred; and
- the methods and procedures applied provide a credible system of quality assurance.

We comment in Sections 2 and 3 on any changes to company systems and processes where the Company has not included in its Board Overview. We report by exception and respond to the specific queries in the Reporter requirements. We comment on confidence grades where we consider the grades shown are inappropriate

1.5. The Company's methods and procedures

The Company takes a structured, comprehensive approach to JR reporting. Reporting Procedures are in place for all tables and table owners are identified. The reporting system that is in place is well understood by the contributors. Procedures are generally suitable and were being used by the auditees. We made some minor recommendations in relation to the Company procedures that have been acted upon following the provision of our audit summaries.

In a number of cases confidence grades have been modified following our challenges, and these are commented upon within this report. We can confirm that all of the identified changes have been altered within the Company's June Return tables prior to submission.

As expected, during our audits we found some variation in the level of self assurance/checking being carried out. In particular, where data production processes involve manual data handling and coding, there is a risk of transcription error. Whilst we cannot guarantee that all errors have been detected, we have carried out summary checks and audits trails on the spreadsheets that have been used and, to the extent revealed by our audits, do not consider that any material errors remain within the reported figures.

In the few instances where we have identified non-compliance with the Reporting Requirements and it has not been possible or appropriate to amend the reported figures prior to submission, the Company has disclosed these in its Board Overview and we have commented accordingly. We have seen no evidence of strategic positioning of numbers or methodologies which might have presented JR11 data favourably in the context of the completion of the AMP5 period.

1.6. Consistency between the Board Overview and supporting documents

We have reviewed Veolia Central Water's Board Overview in detail and have discussed any apparent discrepancies with supporting documents with the Company. Overall, we consider that the information given is reliable and represents a reasonable statement from the Company's standpoint. It is consistent with the numerical information given in the main June Return tables.

1.7. Effectiveness of the June Return process

The June Return process is managed through a Veolia Central project management team, who have helped us to ensure that our audits have been planned and carried out as required, sufficiently well in advance of the Company submission. The process of auditing has been open and constructive, and we have been able to carry out all of the audits that we requested. We can confirm that, where we have requested access to information or further supporting data, this has been provided in a timely and open manner. The Company has been willing to share spreadsheets and base data with us as appropriate, even when these have been at the draft stage.

We have been provided with open and ongoing access to the Company's internal auditors, and have shared findings with them throughout the June Return reporting process. We were provided with the opportunity to present these findings to the Audit Committee, both in private, and in front of the Executive Board. We consider that the Board is genuinely engaged with the reporting process and is actively seeking ongoing improvement from staff and reporting systems. The Company's Board has continuously expressed a commitment to ensuring that processes and procedures can provide reliable, accurate and complete information to the level defined by the assigned confidence grades. We have seen first-hand evidence of the internal governance that is practiced within the Company at Board Level in relation to the June Return.

It should be noted that, whilst we have followed audit trails through to base data, databases and spreadsheets as appropriate, there are a number of key reports that are used to extract information from the billing system and works management systems that we have not been able to systematically review. We have checked the rationale behind these queries, and confirmed inputs, classifications and outputs as appropriate, but this does not guarantee the accuracy of the reports that are generated, as there may be unknown issues associated with structure, data and allocations within the databases themselves. The Company itself has not carried out formal, systematic testing of the queries so this introduces some uncertainty to some of the non-financial measures, however we consider that this is likely to be contained within the confidence grades that are quoted.

2. Commentary on the Board Overview

2.1. Introduction and Board Endorsement

Our comments on Board level engagement in the June Return process are contained in Section 1 of this report. We have no further comment to make on this section.

2.2. VCE Team Design

We confirm that roles and responsibilities in relation to the management of June Return information are generally well understood and do not appear to have been adversely affected by the re-structuring that is described.

2.3. Customer Experience

2.3.1. Response to Billing Contacts (DG6)

As noted in the Board Overview, at audit we identified that the Company's procedures for reporting of DG6 contacts that are received on a non-working day have not been in accordance with the Reporting Requirements for some time. The approach that has been used is consistent with previous June Returns, and hence is consistent with the target that was set for PR09. We note that, although the approach has been described openly in the Company Levels of Service Methodology, this is contained within a statement that relates to contacts received by e-mail and it may not have been apparent that this reporting methodology applied to all DG6 contacts. For clarity, the issue applies to all e-mail and telephone DG6 contacts that are received whilst company operatives are working at the weekend. These are logged at the time of receipt, but 'day 0' of the timeline is then started on the next working day, which obviously affects the reported response time.

In terms of materiality, the potential variance in the reported numbers is within the stated confidence grades (+/- 5%, 0.3% variance) however it would be material in respect of the Company's AMP5 target, as it changes performance from 99.9% to 99.6% compliance.

2.3.2. Response to Written Complaints (DG7)

This is no longer part of the Reporter's scope of audit, so we have no comments to make on this section.

2.3.3. Meter Reading (DG8)

We have no comment with specific reference to the Board Overview.

2.3.4. Ease of Telephone Contact Performance (DG9)

This is no longer part of the Reporter's scope of audit, so we have no comments to make on this section.

2.3.5. GSS

As noted in the Board Overview, we identified weaknesses in some of the processes used for the reporting of GSS appointments, and some issues relating to compliance with the processes that are used. The evidence that we reviewed at audit demonstrates that GSS payments are made when missed appointments are identified on the system, but, given the shortfalls identified in the robustness of the processes and checks, there is the potential that some failed appointments may not be recorded on the system. We could not determine the extent of this risk and did not find any exceptions at audit, so there is no definite inaccuracy within the reported figures. However it was considered that the uncertainty involved is beyond the confidence grades quoted last year and the Company has appropriately lowered its confidence grades for Lines 1 to 3. The Board Overview also highlights the fact that there was some uncertainty in the classification between missed appointments and appointments cancelled without prior notice, which has resulted in the BX confidence grade for Line 3. Further commentary on the above exceptions is provided in **Section 3.1.5** of this report.

As noted in the Board overview, the issue associated with the counting of the DG6 response time has the potential to affect DG6 GSS figures, and the Company has agreed to carry out an investigation to identify any customers who should have received a GSS payment, whether this year or in prior years. This is a relatively time consuming exercise, so it was not realistic to complete it prior to submission of JR11, but it will be reported as appropriate within next year's figures.

2.3.6. Learning from Customer Feedback

This is no longer part of the Reporter's scope of audit, so we have no comments to make on this section.

2.3.7. Service Incentive Mechanism (SIM) Performance

This is not part of the Reporter's scope of audit, so we have no comments to make on this section.

2.3.8. Innovation

This section generally relates to the management of contacts and complaints, which is largely outside the Reporter's scope of audit.

2.4. Operational Performance

2.4.1. Drinking Water Quality

We have no comment to add; comments on serviceability indicators are provided in **Section 2.6** of this report.

2.4.2. Security of Supply

We confirm that the Security of Supply Index has been 100% for this year and has been reported in a manner that is consistent with the PR09 Business Plan and Final Water Resources Management Plan.

In relation to water savings, we confirm that the Company has clearly exceeded its target for this year. Comments on the methodologies used within JR11 Table 1 are provided within **Section 3.1.1** of this report.

2.4.3. Unplanned interruptions to supply (DG3)

Our review of the Company DG3 figures confirm that the relatively high score for this year was caused by the three incidents named in the Board Overview. Our audits indicate that DG3 reporting is within the quoted confidence grades and that the Company's evaluation of the underlying trend in DG3 is reasonable.

2.4.4. Customers at risk of low pressure (DG2)

We note that the additional customers identified during the report year were not detected as a result of changes to the reporting system; rather the low pressure warnings occurred because of the greater demand that was placed on the system. Hence this reflects a physical network, rather than reporting, challenge.

2.4.5. Leakage

In terms of leakage activity, we have reviewed the additional expenditure that has been involved and can broadly confirm the £5.3m figure of additional expenditure quoted. This incorporates a mix of operational and capital (mainly communication pipe replacement) costs. We have also reviewed leak repairs, and confirmed that there was a significant (c. 100%) increase in the amount of repairs that resulted from leak detection activities over the January – March 2011 period. The leakage figures that have been reported by the Company therefore, on a high level, are reflective of the increased activity and costs carried out by the Company in response to the exceptional cold weather.

Because the Company has moved to formal reporting of leakage using 'method B' for this June Return, our review of leakage and the Table 10 water balance therefore concentrated on a number of different aspects of the calculations to determine whether there were any material issues or exceptions to report. These were:

- Confirmation that the pre-MLE leakage figures have been derived in a manner that is consistent with the leakage calculation used to derive the target for PR09.

- Confirmation that other parts of the water balance and the MLE adjustment have been derived in a manner that is consistent with the leakage calculation used to derive the target for PR09.

- A review of the assumptions and methods that underpin the 'method B' evaluation to determine if there are any issues or improvements that need to be identified for potential future updates.

We note that the Company has been particularly open and constructive in its approach to the Table 10 JR audits, and we are supportive of the ongoing investigations that are being carried out.

Overall we confirmed that the method used for both the pre-MLE leakage calculation and the water balance is consistent with that adopted for the PR09 leakage target. The Company made two adjustments to the household night use factor prior to submission as a result of our challenges at audit. This included deferring the use of a summer household night use factor, and modification to the overall household night use allowance in order to ensure that the reported figures are consistent with the PR09 methodology. Variations in non-household night use, hour to day factors and void properties represent updates on inputs for the current methodology and are therefore reasonable to include whilst remaining consistent with the PR09 target. We note that there is some uncertainty within the exceptional use part of the models used to derive non-household night use. This affects around 4Ml/d of the reported figure. Additional field based studies will be required to improve this uncertainty, but we consider that it is highly unlikely that such studies would result in a change to the reported figure that would be large enough to question the achievement of the leakage target for JR11.

In terms of potential future changes to the methodology, there are a number of areas that could significantly affect the reported leakage figure once the Company's studies are complete. These relate to both the leakage calculation and the overall water balance, as described within the Board Overview, and can be summarised as follows:

- The discrepancy between GIS and Hi-Affinity property figures noted in the Board overview currently means that an adjustment is needed in the reported leakage figures to account for the leakage that occurs in areas that are not actively covered by in-year DMA monitoring (due to configuration or meter problems). Because of the geographical distribution of these property discrepancies, this has had to be applied as an absolute adjustment that is not logically supportable in one key part of the methodology that is used. This results in a relatively large, inappropriate downward adjustment of reported leakage, however this is countered by the fact that the passive adjustment has been applied to the whole night-line (rather than just leakage). Overall we estimate that leakage is likely to increase by around 3-4Ml/d once the property discrepancy is addressed.

- Preliminary evaluation of trunk main and service reservoir leakage does indicate that leakage is currently likely to be over-estimated from those assets. There are a number of assumptions in the current work, and further evaluation is needed, but it appears that investigations are likely to result in a downward adjustment to the total leakage figure.

- Investigations to establish a seasonal variation in night use allowance will be an improvement in the methodology, provided robust data can be provided. This is unlikely to result in an overall adjustment to long term average leakage figures, but will mean that in-year leakage will tend to be more accurately reported (i.e. currently it will tend to be over-estimated in a dry year and under-estimated in a wet year).

- We reviewed the household consumption monitor information in some detail. It was notable that some of the outputs from the Watcom 2 monitor were counter intuitive (i.e. counter to normal seasonal trends), so we support the Company's continued reliance on the Watcom 1 monitor. As noted in the Board overview, we consider that regular updates of the 'leakfrog' testing is advisable for Watcom 1, as the potential for a partial inclusion of supply pipe leakage remains the main risk for the monitor. In addition to the Board Commentary, we note that the method used for processing data from the monitor to the reported uPCC figure uses a weighting that is directly related to ACORN grouping. Whilst industry evidence suggests that uPCC can be sensitive to ACORN classification (particularly ACORN group A), this correlation is uncertain and, to date, the Company has not determined whether a direct weighting from the monitor to the unmeasured population as a whole is statistically valid. The adopted method for weighting uPCC currently results in an increase from 160l/h/d in the monitor to 167l/h/d in the water balance (pre meter under-registration and MLE adjustment). The Company has indicated that it will review its approach to weighting as part of its overall methodological reviews during AMP5.

Although there are a number of areas of investigation, we consider that it is unlikely that this would result in the magnitude of adjustment that occurred following the movement from the 'Method A' to the 'Method B' reporting. Although it is difficult to quantify at this stage, it is likely that the adjustment would be within the +/- 10% suggested by the 'B3' confidence grade quoted for distribution losses.

2.5. Health & Safety

This is not part of the Reporter's scope of audit, so we have no comments to make on this section.

2.6. Asset performance

2.6.1. Serviceability non-infrastructure

Our audits confirmed that the Company has moved to an electronically based reporting system for the unplanned maintenance that is carried out by Production staff. Company analysis of the increase in planned maintenance indicates that work allocated from the Control Centre has remained stable, whilst Production based figures have increased. This would suggest that the observed increase is generally related to the change in reporting rather than an actual deterioration in serviceability.

We note that the new system is still being rolled out to some smaller business units, and measures have been put in place to re-iterate the importance of planning all work through AMIS in the field to ensure data is captured. This is appropriate, but it does mean that serviceability trend data for the unplanned maintenance figures is likely to be related to reporting systems as much as it is asset condition at least until JR12. On this basis we challenged the Company over the assigned confidence grade for Line 5 of Table 11a, and they have accordingly reduced it to a B3 until the system is completely 'bedded in'.

It should be noted that the majority of the change in reported turbidity is actually as a result of funded activity to refurbish sampling points within the monitoring system, which has reduced known problems with turbidity at sample points. The very low reported figure for this year is therefore likely to be more reflective of the underlying asset base than the previous year's data.

For serviceability indicators that are associated with DWI reports we have not trailed to the base input data as this is effectively audited by DWI.

2.6.2. Serviceability infrastructure

We have already commented upon DG3 figures and reported distribution losses within **Sections 2.4.3 and 2.4.5** of this report, and we agree with the explanation of serviceability trends provided in the Board Overview. Trends in leakage levels are affected by the change from 'method A' to 'method B' reporting, as described above, and we can confirm that reported leakage has reduced on a like-for-like reporting basis from JR10 to JR11.

Our review of the reported burst figures confirm that the methodologies and adjustments commented upon in the Board Overview are consistent with previous years and are subject to a high level of review and scrutiny. We note that the Company has tended to reduce the number of communication pipe replacements that are carried out during mains renewals programmes in recent years, and it appears that this may be resulting in an increase in the number of reactive ferrule repairs that are being reported. This helps to explain why the number of mains bursts that exclude ferrule repairs has reduced more significantly between JR10 and JR11 compared with the number of bursts when ferrule repairs are included – i.e. the rise in ferrule leaks has masked the underlying improvement in mains bursts.

2.6.3. Mains replacement

The Board Overview is a fair reflection of the progress achieved by the Company this year, and we have no material comments on the figures quoted.

2.7. Finance & Regulation

2.7.1. Operating Performance

We note in the Board Overview that the Company has identified some £5.3m of atypical costs including £3.4m in the last quarter of the year related to leakage control activity associated with the severe winter weather. As noted previously, we have reviewed the relevant business unit budget lines and confirm that these costs do appear to be exceptional and result from the very cold winter. The Company confirmed to us that its accounting treatment for leakage expenditure is consistent with JR10.

We confirm that the accounting separation methodology for opex, in particular that related to the allocation of G&S expenditure across the business units, has improved the robustness of the analysis and addresses concerns raised by the Reporter in the context of JR10. Further commentary on this, and allocation of operational costs between business units, is provided in **Section 3.3.1.** As noted in the Board Overview, at audit we identified that some £3m of costs that had been allocated to the Raw Water Distribution Unit in Table 21a had been allocated in part to water distribution in Table 21. The Company has corrected this in its final submission. Historically we believe the Company may have been over-reporting its water distribution direct costs and under-reporting its resources and treatment direct costs by up to 7%. This only affects the separation calculations, and does not affect the total reported opex figures.

2.7.2. Infrastructure renewals charge and depreciation

As noted in the Board Overview, our review of the CCD reporting system has highlighted some issues with the way that depreciation is started on some assets that are entered into the Fixed Asset Register (FAR). This has not had a significant impact on the overall reported CCD figures for this year, mainly because total CCD for pre 2008 assets (which are affected by the reporting issue) has been changed in JR11 to equal the PR09 MEAV assessment rather than the outputs from the FAR reporting system. The split within Table 33 is affected, as described within **Section 3.5** of this report.

2.7.3. Land Sales

We have no comments to make on this section.

2.7.4. Capital Expenditure

We consider that the Board's presentation of mains renewal and unit costs is a fair reflection of the progress achieved this year.

We note that around £1.4m of the reported over-spend associated with non-infrastructure SDB expenditure is associated with pre AMP5 schemes/developments and allocation of overhead costs, rather than actual AMP5 growth related costs (i.e. new connections, mains diversions and meters). Further commentary of this is provided in **Section 3.5** of this report.

2.7.5. Financing

We have no comments to make on this section.

2.7.6. Dividends

We have no comments to make on this section.

2.8. Efficiency

We have not specifically reviewed opex efficiency as this is beyond the scope of our audit. Our comments on movements in reported operational costs are provided within **Section 2.7.1** of this report.

2.9. Regulatory Compliance

Our comments on the figures reported in this section are provided elsewhere within this report. Comments on corporate governance are provided in **Section 1.7.** of this report

2.10. Competition and market reform

We have no comments to make on this section.

2.11. Corporate Responsibility

We have no material comments to make on this section other than to note the change in confidence grades for Greenhouse Gas reporting compared with JR10. Our comments on this are provided in **Section 3.6** of this report.

Comments regarding water efficiency assumptions have already been made under **Section 2.4.2.**

2.12. VWC vision and strategy

We have no comments to make on this section.

3. Exception Reporting by Table

This section includes comments on all material changes, exceptions and issues as identified for each of the Tables audited by the Reporter team that have not been commented upon in our response to the Board Overview. Specific requirements as identified by Ofwat for JR11 are explicitly addressed where appropriate.

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

3.1.1. Table 1: Water Efficiency

Specific guidance to the Reporter for this Table is as follows:

Annual target
- where a company has not met its annual base service water efficiency target, confirm whether the company has got a credible plan to meet targets in future years.

Assumed savings
- the reasons why a company has not used the assumptions provided in the appendix to the table 1 reporting requirements.
- any claimed savings towards l/p/d targets from the provision of information to its consumers where the guidance in the UKWIR Report - Ref No: 09/WR/25/4: ''Estimating the water savings for baseline efficiency activities'' has not been followed.'

We confirm that the company methodology and assumptions are in line with the appendix to Table 1. Whilst we have raised a number of challenges to the way in which data has been derived and the assumptions have been applied, the Company has achieved water savings that are significantly in excess of its annual base service water efficiency target, and we do not consider that the challenges raised would result in the Company failing to meet its target for JR11. The challenges and assumptions raised are not therefore considered to be material and are summarised in Appendix 1 to this report.

In terms of methodology, we note that the Company has now started to report the impact that its leak rebate policy is having upon customer side losses for measured customers. This policy has been running for a number of years and it assists measured customers to identify and pay for repairing leaks, both on supply pipes and on internal plumbing. The Company has a process for alerting customers of high usage and offers a rebate on bills equal to the cost of carrying out a leak repair, up to the amount that is estimated to have been lost through the leak. This policy includes both internal and external leakage costs, and has the potential to save significant amounts of water by reducing the run time of customer side leaks. For JR11, the reported figures are based on a detailed analysis of all leakage rebates to determine where the policy appears to have influenced the customer to repair a leak. Currently the analysis only covers 7 months of the year (due to time constraints on reporting), but it does assume that all of the rebate value is directly translated into water saved. In reality the amount of water saved will reflect the difference in run time that occurs due to the leak rebate being in place. For future report years it would therefore be more appropriate to estimate the net impact that the rebate service has in comparison to the 'normal' metered situation. We confirm that the assumptions used this year do not affect the Company's achievement of its JR11 target and are likely to be a fair, if somewhat uncertain, reflection of the total water saved in the year. This could become a material issue for future report years, particularly if the Company is closer to its base service water efficiency target.

3.1.2. Table 2:

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- where the methods used by the company are not as the company has described or where the methodology has changed or is inappropriate.

We did not encounter any material or significant exceptions during the course of our audits. Comments relating to trends in DG2 and DG3 are provided within **Sections 2.4.3 and 2.4.4** of this report. A few non-material exceptions and challenges were raised during our audits; these are summarised in Appendix 1 to this report.

3.1.3. Table 4: DG6

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- where the methods used by the company are not as the company has described or where the methodology has changed or is inappropriate.

The only material exception for DG6 relates to the reporting of DG6 contacts that are received at the weekend, as described in the Board Overview and our commentary in **Section 2.3.1** of this report. Other non-material comments are provided in Appendix 1 to this report.

3.1.4. Table 5: Customer Service (DG8)

Specific guidance to the Reporter for this Table is as follows:

DG8

- where the methods used by the company are not as the company has described or where the methodology has changed or is inappropriate.

We have no material comments or exceptions to report for this table. A non-material issue relating to the query used to report on combination meters is summarised in Appendix 1.

3.1.5. Table 6 GSS:

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- where the methods used by the company are not as the company has described or where the methodology has changed or is inappropriate.

As discussed in **Section 2.3.5**, we did identify some weaknesses in the adequacy of the processes and methodology for managing GSS appointments, which resulted in a reduction in confidence grades for Lines 1-3. Evidence demonstrates that GSS payments are made where events are reported, but the company cannot actively identify whether representatives are actually recording missed appointments through the system. The weaknesses within the procedures can be summarised as follows:

- some gaps in the Company's methodology documentation as the end-to-end processes are not fully documented.
- weaknesses in some of the individual business level processes
- failure to comply with some processes
- inconsistency in the type of internal quality assurance checks made by different parts of the business
- contractors offering a small number of all day time slots to customers

The main issue relates to the fact that the actual arrival time is not systematically captured across the Company. There is often enough associated evidence to demonstrate that the appointment was met, but this is not actively captured by the systems. It should be noted that we did not actually encounter any exceptions during our audit trails, but the lack of arrival time information, particularly from contractors, means that uncertainty exists in relation to the capturing of all missed appointments. This uncertainty may be outside of the A2 confidence grade, so the Company has amended the grades as a precautionary measure until reporting procedures are improved. Because some contractors and business units did not realise the difference between missed appointments and appointments cancelled without sufficient notice, it was agreed that a BX confidence grade would be appropriate for Line 3 due to the small number of appointments in that line.

Our discussions with the Company also revealed that one part of the business occasionally offered and agreed all day time slots with customers as they were not aware that this is not permitted under the GSS regulations. We understand that the numbers involved are very small though we have not carried out any checks to verify if this is the case. The Company agreed to halt this practice immediately.

Historically there had been a misinterpretation of the line definitions in relation to exclusions, which had been included in Line 21 but not the relevant categories in other lines. We notified the Company of this and they re-stated the events in the appropriate lines prior to the submission of the JR11 figures. We note that the Company has not been systematically compiling evidence for the days that it is excluding events in Line 21, but it is able to retrospectively gather and present the evidence to confirm the validity of its exclusions.

3.2. Non-Financial Measures (Tables 7, 8, 10, 10a-b, 11, 11a, 12)

3.2.1. Table 7: Properties and Population

Specific guidance to the Reporter for this Table is as follows (comment by exception on):

- the company's population and property estimates if the methodology for calculating the estimates has changed.

We did not encounter any material or significant exceptions during the course of our audits. We note that the review of properties provided by the ONS database, as described in Section 4.5.3 of the Board Overview, may result in the addition of a few thousand properties to the billing system in JR12.

The reporting of properties is taken directly from the Hi-Affinity billing system report, which is consistent with previous years. A few non-material exceptions and challenges were raised during our audits in relation to the reporting of internally metered properties and allocation procedures; these are summarised in Appendix 1 to this report.

Assumptions relating to populations are entirely consistent with the demand forecast model used for PR09 and the WRMP.

3.2.2. Table 8: Metering

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- time lags between carrying out and recording activities;
- changes to the company's metering policy/procedures.

We have no material comments or exceptions to report for this table. A number of non-material exceptions and challenges were raised during our audits; these are summarised in Appendix 1 to this report.

3.2.3. Table 10: Water Delivered

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- exceptions and areas of concern in calculating the water balance for example, where policies do not meet the reporting requirements;
- and comment where the companies have not populated this table in a way that shows the true trend in components such as total leakage and where this is not the case comment;
- any changes to the water balance and quantify what the impact of that change on leakage is;
- total leakage where it has not been reported in a way that is consistent with the leakage targets.

We have addressed all of these aspects in our response to the Board Overview, as described in **Section 2.4.5.** We have no further material comments to add in this section.

A number of non-material exceptions and challenges were raised during our audits; these are summarised in Appendix 1 to this report.

3.2.4. Table 10a: SOSi Index – Planned Level of Service

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- where the company has not followed the RD 03/02 guidance for calculating the SoSI if this is not explained by the company in the overview;
- any difference between the figures used in the water resource plan updates and those used to calculate the index;
- the Water Resource planning where companies have not followed the definitions set out in the Environment Agency's Water Resource Planning Guidelines for the following: water available for use and reporting year distribution input.
- any inconsistencies between the reference level of service used to calculate the index and that used in the Environment Agency '1997 Reassessment of Water Company Yields'.
- any dry year adjustments if the company uses a different ratio to adjust the report year to a dry year than it uses in its resource plan.
- the company's progress against its SoSI AMP5 profile if it looks in the reporter's opinion unlikely to be achieved.

We confirm that all reporting is consistent with the sources named above and we have no material comments or exceptions to report for this table.

3.2.5. Table 10b: Environment Agency Data – Annual Average Out-Turns

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- material differences between out-turn data and corresponding water resources plan data.

The main material difference between out-turn data and the WRMP relates to the number of assumed meter installations, as the Company was not funded for change of occupier metering within the AMP5 Final Determination. The reported out-turn distribution input is in line with a normal year level of demand.

At audit we saw that there is a difference of around 24Ml/d between the Table 10 Distribution Input (Table 10) figure and the total recorded abstraction in Table 10b. This is approximately twice the 12Ml/d process losses that were assumed within the PR09 WRMP/FBP, and, whilst the difference is within the margin of error that would commonly be attributed to the flow meters that are used, it is towards the realistic outer limits of that margin. We have therefore recommended that this is investigated during JR12 in order to confirm that the discrepancy is purely associated with random meter measurement errors.

3.2.6. Water service activities – table 11

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- the distribution studies carried out and/or updated conform with the guidance given in the definitions;
- any inconsistent network activity in comparison to the company's policy;
- the company's meter replacement policy in delivering the final determination outputs.

Comments on mains bursts are provided as a response to the Board Overview in **Section 2.6.2** of this report.

We have no material exceptions to note for this table. We note that the network distribution teams have been largely employed on leakage control support and other activities this year, so there have been no distribution studies completed within the report year.

A few non-material exceptions and challenges were raised during our audits; these are summarised in Appendix 1 to this report.

3.2.7. Water service serviceability indicators – table 11a

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- the validity of the serviceability assessment made by the company for these indicators and the overall sub-service assessment;
- where the company has not used data which reconciles with the data provided in the 'serviceability tool kit' to make the serviceability assessment for water non-infrastructure indicators;
- the Companies' exclusion of non-routine samples and review the exclusion of works on the basis of insufficient data or gaps in the data. Comment where the criteria have been incorrectly applied or there are inconsistencies or where exclusion of samples is having a material affect on results;
- any inconsistencies or inappropriate reporting of unplanned, planned maintenance work and the suitability of the company definition of unplanned maintenance.
- any calculations made for the indicators which are not in line with the company's stated procedures.

The Company serviceability assessment has been made in line with the 'serviceability tool kit', and, with the exception of the reporting issues noted in the Board Overview and under **Section 2.6** of this report, the assessment reconciles with the base data. Exclusions for non-infrastructure have been handled appropriately and do not materially affect the reported figures.

3.2.8. Water explanatory factors – table 12

Specific guidance to the Reporter for this Table is as follows:

- material changes to source and treatment types from the last June Return;
- inappropriate or inappropriately applied average pumping head methodologies;
- inappropriate approaches to counting and categorising sources.

There has been a material change in the reported number of works from the last June Return. This is not a physical change but rather a reporting methodology change in line with Ofwat Reporting Requirements. Previously the Company reported the number of bulk imports as works. The Company is now correctly excluding these. The Company has not commissioned any sites in 2010/11 and the number of works that should have been reported for JR10 is 83.

We note that the Company continues to report on assumed pumping heads, which is consistent with previous years but does not make use of the telemetry data that is available.

3.3. Regulatory Accounts – Current Cost Accounting (Tables 21, 21a-b & 25 a/b/c)

3.3.1. Activity costing analysis – Water service 1 – table 21

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- significant changes in costs where these have not been commented on by the company in the overview, particularly where they relate to changes in operating conditions such as drought or cold weather.
- inappropriate or inconsistent cost allocation procedures or cost drivers being applied or where the methodology has changed from the previous year.

Our comments on exceptions in operating costs are provided as a response to the Board Overview within **Section 2.7.1** of this report. The Board Overview summarises the movement in costs from those reported in JR10.

In terms of allocations between business units, we note that the variances in power costs for resources and treatment and distribution also reflect the correction of the allocation of raw water distribution costs of some £2.2m. The increase in associated company costs relates to the costs associated with the parent company capability centre. These costs effectively represent a transfer of activity from direct payroll to the shared Capability Centre, which has been carried out to improve efficiency. The Company told us that these movements specifically related to network costs. The movement in other direct costs reflects the atypical credit of £0.6m summarised in the Board Overview related to the settlement of the dispute with the EA over abstraction from the River Ver, and recovery of costs in relation to bromate contamination of ground water.

The Company's primary basis for the allocation of costs is undertaken in the context of accounting separation Tables 21a and 21b. These are then mapped across to Table 21 to provide for consistency in cost allocation between the tables. The Company has revised its accounting separation methodology, with particular improvements in the allocation of General and Support Costs, to bring these into line with Ofwat accounting separation guidance. This has provided a more robust allocation across business units of some £10m of G&S costs.

In the mapping of costs to Table 21 we identified a number of non-material cost allocation issues related to the treatment of customer services costs in the context of Table 21 reporting requirements, which we detail in Appendix 1. The Company reviewed and revised its allocations prior to submission to bring them into line with Ofwat reporting requirements, with the exception of some £400K related to customer network enquiries, which we believe should be allocated to water distribution in Table 21 but which the Company has allocated to line 13 customer services.

Overall, we believe that the changes in methodology and correction of Table 21 allocations have enhanced the robustness of the reported data. The Company has maintained records detailing their reasoning for changes in methodology and cost allocation from previous years, and have documentation to support the basis on which they have allocated these costs, which includes details of any assumptions made.

3.3.2. Activity costing analysis – Water service 2 – table 21a &Retail services – table 21b

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- inappropriate or inconsistent cost allocation procedures or cost drivers being applied or where the methodology has changed from the previous year.

We have commented upon the changes in methodology in the context of Table 21 above.

3.3.3. Analysis of fixed assets by business unit – table 25 a/b/c

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- inappropriate systems and processes or where a company has made changes to systems and processes.
- the allocation of the fixed assets, CCD and population of the table where any changes to the systems and process seem inappropriate or inconsistent;
- inconsistencies with the guidance and assets identified at boundary points;
- inappropriate assumptions or adjustments underlying the allocations and population of the fixed assets table.

The PR09 MEAV revaluation has been included within the reported figures for JR11, so relevant AMP adjustments have been necessary in Table 25 a & c. We confirmed that this has been carried out correctly against the relevant PR09 table outputs, but note the following:

- For Table 25, there is a large MEAV that was attributed to land assets in the PR09 valuation. This was omitted from the PR04 assessment and equals some £1.2bn. The Company had originally allocated this to 'other assets'. However, the detailed JR T25a/c guidance on asset allocation indicates that land should be allocated between business units on an area basis to the operational assets that it supports, so, following our audit, the Company has assigned this land value to the 'operational assets' category for water treatment.

- The allocation of assets between business units within Table 25 a&c has been carried out using gross total asset figures apportioned entirely according to the ratios contained within the PR09 Asset Inventory. The total asset value has been increased in line with additions since then, but ratios will remain constant until the next re-valuation. Although this is a very simplistic approach, it means that the distribution of MEAV into Tables 25a&c is consistent with Business Plan outputs. This approach means that it is not possible to comment on inconsistencies for the allocation of individual assets, as the Company has not completed the table using an asset led approach.

- The above approach means that 7% of infrastructure customer ancillaries has been allocated to retail, as this is in line with the assumptions used in the PR09 FBP, tab B7_13 (lines 16 & 17), but is purely as a result of the fact that the same customer ancillaries split has been used for infrastructure and non-infrastructure assets. This results in the overall £41m allocated to retail infrastructure that is shown in Table 25c.

3.4. Expenditure Comparisons by Purpose (Tables 35a & 35b)

3.4.1. Water Service - table 35a

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- the company's progress with the delivery of outputs as set out in the 2010 supplementary report where there is a significant risk of any of the outputs not being achieved to time or scope and where these programme changes have not been noted in the overview;
- unreasonable variations in expenditure observed in audit.

We note that infrastructure renewals expenditure has increased this year largely as a result of the carry-over of mains renewals activity from last year, along with a slight out-performance on length delivered against the FD target for this year.

For MNI (lines 3-5), the majority of the variation from the FD relates to a delay in starting the capital programme, which is largely due to the 'Well Defined Need' (WDN) process that has been implemented to provide additional challenge to capital governance and project justification. As noted under Table 35b below, the actual variation in the AMP5 capital programme is larger than the apparent variation shown in Line 3, as over £4m of the 2010/11 MNI expenditure relates to the completion of projects contained in the AMP4 capital programme. Total AMP5 MNI deferral is therefore in the order of £11m.

The significant increases that are apparent within SDB expenditure when compared with the FD are largely associated with the increase in housing development activity, as described within the Board Overview. This is reflected in the increase in both gross costs and contributions. As noted previously, around £1.4m expenditure is associated with costs that are either associated with historic spend (£300k is associated with a legal claim relating to a bulk raw water main that has been in place for a number of years), or assumptions relating to programme management allocation.

The Company methodology for assessing enhancement opex is consistent with JR10, and the confidence grades are unchanged. We believe the uncertainty related to identifying the incremental opex associated with capital additions, and the underlying issues related to disentangling such opex from movements in the base, is properly reflected in the reported confidence grades. We challenged the Company on the confidence grade assigned to total opex in Tables 35 and 35a, as total opex reported is consistent with Table 21 and it does not involve the uncertainty associated with splitting total opex between base and enhancement. We therefore consider that a higher confidence grade for total opex is appropriate.

Some 88% of enhancement opex relates to the additional metering opex associated with new connections and meter optants. The approach of number of meters x unit costs is consistent with JR10 with unit costs uplifted by RPI.

3.4.2. Water Service - Capex variance from 2009 final determination - table 35b

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- where there are any cases where savings have been achieved now but where this will result in additional capital expenditure being necessary in the future;
- lines 25 – 30 whether the variances are associated with expenditure of delayed AMP4 outputs and state whether the outputs have been delivered.

As it is very early in the AMP cycle, the Company has not yet claimed any significant efficiencies within its programme. The Company does have a list of the current anticipated cost variances for individual schemes as a result of the new 'Well Defined Need' process, which indicate that the following potentially significant variations may occur within the capital programme:

- The largest overall changes (including cost reduction on the Iver optimisation and Egham schemes) relate to an 'over-prediction of need' within the Predictive Maintenance Tool that was used to estimate MNI in the PR09 submission. Most of this is simply associated with the fact that, on further review, expenditure within certain projects can be deferred until AMP6 or beyond. This simply highlights the largely inevitable uncertainties that exist within Business Plan capital maintenance predictions. Where savings are realised then the Company currently anticipates that it will bring forward other schemes that are required in order to match the overall MNI Capital Programme allowance contained within the Final Determination. At this stage we do not therefore anticipate that efficiency savings will be claimed for this category in future report years.

- There were a number of sizeable potential savings identified for SEMD schemes, where the Company will be trying to either reduce the number of assets that require protection or take actions that will result in a lower classification for assets, rather than simply protecting its existing asset base. This sort of response was not generally considered within the PR09 evaluation process, as it tends to require more detailed engineering assessments than are used during the Business Plan process. It does represent innovative thinking for this asset category, and currently it is not clear if the savings will be achieved. However, we consider that Ofwat should be aware that this type of approach is feasible for cost reductions on SEMD schemes, particularly if further SEMD schemes are going to be considered in PR14.

We confirm that most of the variances indicated within lines 25-30 do relate to AMP4 schemes. These are all now complete, with the exception of relatively minor works on some of the MNI schemes that were included.

3.5. Financial Measures (Tables 32, 33, 34, 35 & 37)

3.5.1. Analysis of fixed asset additions and asset maintenance by asset type (Current Cost Accounting) - table 32

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- unreasonable proportional allocation rules or where those rules are not followed.

The Company capital monitoring system remains high level, with a single purpose driver for each project. These are generally appropriate and projects are reviewed each year to determine whether or not significant proportional allocation is warranted, and our audits confirmed that the approach that has been used is generally appropriate. However, we consider that more representative proportional allocation will be possible when the Company moves to its new finance system this year, which will allow different purpose codes to be assigned to sub project tasks.

We note that some of the overhead costs have been very simply apportioned and, as described previously, the MACE project management codes have been incorrectly apportioned because the split has been based on JR10 activity. This is not material overall for Table 32, but has resulted in the mis-allocation of around £173k to quality drivers (bromates) and £134k to SDB (pumping stations for new resources schemes).

3.5.2. Accounting charges – (current cost accounting) - table 33

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- on any changes to the systems, methodologies and processes from those in operation the previous year;
- any unreasonable assumptions or adjustments explaining the basis of that opinion;
- any unexpected movements and changes to the CCD from those projected in the PR09 final business plan to the actuals.

Infrastructure renewals charge:

- the company's policy for infrastructure renewals charge where it is inconsistent with the calculation of the infrastructure renewals charge;
- the company's policy including IRE projections where it is not reflective of the company's medium to long-term view of infrastructure renewals expenditure.
- unreasonable expectations for infrastructure renewals accrual/prepayment to be wound out.

The Company has now introduced the PR09 MEAV revaluation as the basis for its reporting of CCD for pre 2008 assets, so the total projected PR09 CCD for assets has been entered into line 7 (for assets existing at 2008). Lines 5 & 6 are then calculated based on the actual Project Accounting based CCD for assets added between 2003 and 2008, and lines 2 and 3 are then simply calculated to provide a balance against Line 7. Overall reporting assumptions are therefore entirely consistent with PR09, but this is done at the macro level using this reconciliation approach.

As noted in **Section 2.7.2**, our audits showed that the process for determining the date at which a project is considered to be complete and added to the Fixed Asset Register is not clear and inappropriate dates have been added for larger projects where expenditure is spread over a number of years, or project codes are used that reflect ongoing activities such as overheads. The way the spreadsheet handles initial CCD means that most of the impact occurs when assets near the end of their operational life, and hence there is relatively little error for newer assets, so the impact on post 08 assets (lines 8 and 9) is not yet material. Line 7 is not affected because it reflects the PR09 MEAV revaluation. The only impact is therefore on the split between lines 5/6 and lines 2/3, which will contain an unknown error that may affect up to 5% of the reported asset CCD. We note that the Company is in the process of upgrading its finance system in any case, and intends to resolve this issue as part of the move to that new system.

Infrastructure renewals charge calculations are consistent with previous years, are reflective of Final Business Plan forecasts of IRE and contain what we consider to be realistic assumptions relating to the windout of accruals.

3.5.3. Analysis of non-infrastructure fixed asset additions by life categories (current cost accounting) - table 34

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- changes to the systems, methodologies and processes from those in operation the previous year;
- inconsistent or unreasonable rules adopted by the company for allocation of expenditure to life categories and whether these rules have been applied or changed from the previous year;
- the financial asset lives where they do not reflect the operational lives or the apportionment of expenditure across the assets;
- inconsistencies between engineering and financial judgements on asset lives and investment allocation.

Asset life categories are assigned by project manager engineers using a code based framework within the project accounting system. All allocation of categories is consistent with previous years, and this attribute of reporting is not affected by the project start date issues discussed for Table 33. As with the capital allocation spreadsheets, asset lives are defined on a whole project basis so will remain at a high level of granularity until the new finance system is introduced.

3.5.4. Water service - expenditure by purpose - table 35

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- any change in the company's policy of allocating leakage expenditure from that adopted for previous years;
- new expenditure included in line 14 where this is for new obligations identified for the AMP5 programme, such work not having been included in the 2009 determination which the company has not highlighted in the overview.

The capitalisation of leakage costs was challenged, particularly in light of the increases in expenditure seen in the report year. It was found to be consistent with previous years and only includes items such as new equipment and modelling systems. The 'leakage' capex referred to within **Section 2.4.5** of our Board Overview commentary relates to infrastructure renewals (primarily CP replacement activity) carried out under the leakage team budget, and does not relate to the capitalisation of leakage detection or repair activities.

Comments relating to overall proportional allocation are provided under Table 32 above. The minor issues described under Table 32 are within the confidence grades that are quoted for Table 35 and 37.

3.5.5. Water compliance - expenditure report - table 37

Specific guidance to the Reporter for this Table is as follows (comment by exception):

- any non-trivial changes to works or schemes that have not been completed to the schedules for the report year as laid out in Ofwat's quality enhancement project schedules (Annex 4-W) not identified in the overview. Where the outputs do not match expectations the reporter should ascertain and give an opinion on the reasons for any shortfalls;
- any schemes have been delivered at significantly reduced costs compared to the PR09 proposals;
- any unspent capex being claimed as an efficiency as we need assurance that the final solution implemented was not a viable option that should have been considered at the time of the PR09

final business plan submission;

- the cumulative effect of trivial changes (e.g. minor delays) and any material impact on the delivery of the quality enhancement programme or the ability of the company to meet statutory completion dates;
- the proportional allocation of expenditure for distribution mains and quality where it is materially different from the business plan or where the methodology to calculate the proportions has changed;
- the methodologies used by the company to proportionally allocate expenditure at new or modified works to the various water compliance categories if it differs from that used in the company business plan at the periodic review;
- lines 9-13 where the expenditure does not relate to Section 19 undertakings for quality parameters in the distribution system.

Expenditure on quality enhancement schemes has been small within the report year and relates to minor adjustments from previous years, expenditure on the cryptosporidium programme and overhead cost allocation, as described under Table 32. There are no non-trivial shortfalls or changes, and the Company is not indenting to claim efficiency savings for quality obligations at this stage.

Comments on potential efficiency savings for security schemes (line 14) are described within this report under Table 35b. We note that savings have not been claimed for the work carried out within the JR11 report year. Expenditure on the environmental programme relates to NEP investigations. There may be some efficiencies for this category in future years, but these are likely to relate to straightforward procurement savings.

3.6. Greenhouse Gas Accounting (Table 42)

Specific guidance to the Reporter for this Table is as follows:

- inappropriate and/or poorly documented systems to derive greenhouse gas emissions (i.e. those that are being incorrectly implemented or managed);
- material omissions and or poorly justified or evidenced assumptions;
- carbon strategies, targets and future work that do not align with the reported emissions figures.

The Company has an established procedure for its carbon accounting process, which is generally followed, although we have recommended that more frequent reviews are carried out to ensure reporting requirements and processes are captured. As noted within the Board Overview we challenged the confidence grades that were assigned to parts of the greenhouse gas accounting calculations, which require lower grades than those quoted for the aggregate calculations required for the JR10 Board Overview. We confirm that the confidence grades used for the JR11 reported figures are appropriate for the level of dis-aggregation involved. A number of other non-material challenges were raised during our audits and were successfully resolved, as described in Appendix 1.

Appendix 1: Summary of Issues and Exceptions

During the course of our audits we identified a number of issues and exceptions that were either addressed prior to submission or are not considered to be significant or material enough to be included within the body of the main report. Those issues/exceptions that were considered to be non-trivial are summarised in **Table 1**, along with the outcome prior to the Company's JR11 submission.

Table 1: Exceptions Identified at Audit

Table	Line/ Block/ Category	Type of exception*	Reporting Exception/Issue	Outcome for JR11
1	Cistern displacement devices assumption (Line 2)	Assumption used	Where >1 Cistern Displacement Device (e.g. Hippo and Save-a-Flush) have been distributed to the same household, the assumption for the saving realised is based on a single device being installed, which is in line with Ofwat guidance. However, this data de-duplication process assumes that the Hippo is installed (2 litres saved) rather than the Save-a-flush (1 litre saved). This is not a conservative approach, and contradicted some of the anecdotal evidence provided by the auditee about the cistern stock that exists within the customer base.	The Company will consider amending this assumption for the next JR year (non-material issue for reasons described later).
1	Internal leakage assumptions (Line 11)	Change in methodology	**Item covered within main report text.**	Company will review before full year savings are reported in future years.
1	Customer behaviour (line 12)	Assumptions used	We noted the following issues associated with the assumptions used for this line. These are not exceptions to the Reporting Requirements, as they do follow the RR appendix, but there are issues over the logic or evidence that has been used for reporting: • 'High level' engagement and associated savings have been assumed for all education centre activities. This includes both water saving-based and non-water saving-based days. For the non water saving based days, this categorisation is considered to be borderline when considered against the spirit and letter of the UKWIR guidance. Further evidence of active engagement .after the day would be desirable. • Whilst the level of engagement from website use is appropriate, the Company uses a count of total clicks on its water efficiency related website pages to estimate behavioural change savings. This is highly unlikely to reflect a count of individual visitors to relevant pages as one visit involves numerous clicks.	Company will consider gathering additional evidence or changing assumptions.
1	Other (general)	Assumptions used	We note that the Company has not included the savings from a number of activities that it does carry out (e.g. water audits, community talks) as these take savings for individual categories well beyond the RR 'cap'.	The Company may seek to legitimately include these in the future JRs if savings are closer to target or the cap is removed.
2	DG3	Adequacy of procedures or methodology	Contractor returns for Overruns. The Company should reconcile this figure to the number of GSS payments made to demonstrate that the correct number of GSS were paid. This is not a material issue, but considering history of GSS in the industry (MD220) this type of reconciliation is essential.	Demonstrate that contractor returns from overruns are reconciled to GSS payments.

4	DG6	Not in line with the RRs	DG6 reporting for weekend contacts – **item covered in main report text.**	See Board Overview for comment.
4	DG6	Adequacy of procedures or methodology	While we appreciate that the checks that are used for DG6 compliance serve wider business purposes, we believe they could more explicitly be used to monitor and demonstrate compliance. Checks could be designed to include a section which takes account of DG6 compliance relating both to quality (substantive response to all points raised) and quantitative compliance (correct timescales being reported) and that a summary of findings could then be compiled which would provide a robust basis to ascertain confidence grades.	Company will consider observations made about current checks.
5	DG8	Assumption used	We consider that the search query used to identify combination meters does not demonstrate that all these meters are necessarily being captured.	Company investigating the possibility of improving query for capturing combination meters; unlikely to affect the A1 CG.
6	DG6 GSS	Potential non compliance with the RRs	We challenged the Company that there was the potential that the issue associated with the counting of the response time could have a knock-on effect for DG6 GSS reporting. The Company concurred and one additional GSS event and payment has already been identified (though this has not been added to the reported numbers).	It was agreed that the Company would identify all customers who should have received a GSS payment, whether this year or in prior years, and ensure that a GSS payment is made.
6	GSS appointments	Adequacy of procedures or methodology	**Item covered in main report text.**	The Company acknowledged that the June Return audits identified some weaknesses in parts of the business in the recording of appointment details. It does not believe this has led to customers failing to receive payments when due. Confidence grades have been changed accordingly.
6	GSS appointments	Error	We identified what we believed to be one additional GSS event and payment (Ref. 4504452, 6/8/10), but this has not been added to the final reported figures.	Non-material error in the reported figure.
6	GSS appointments	Not in line with RRs	Our discussions with the Company revealed that all day time slots are sometimes agreed with a customer by one of its metering contractors. This is not permitted under the GSS regulations and where identified, customers would be due a GSS payment under Table 6 Line 1. We were able to confirm that this practice was limited to this one discrete part of the business and we understand that the numbers involved are very small though we have not carried out any checks to verify if this is the case. If the Company is able to identify where these have occurred, it should consider reporting these as events and making GSS payments.	Non-material issue; the Company agreed to halt this practice immediately.
6	GSS appointments	Adequacy of procedures or methodology	We challenged the Company that there appears to be a lack of an overall owner in Veolia Central for GSS appointments in the same way that there is an individual responsible for other customer services areas, e.g. DG6, DG7, DG8, with the result that issues of potential non compliance or weaknesses in Company process may not be identified or resolved.	The Company acknowledged that the June Return audits identified some weaknesses in parts of the business in the recording of appointment details. And will address this in JR12 report year.

6	Blocks D and E	Adequacy of procedures or methodology	We identified a weakness in the audit trail in that the decision-making on which events should receive payments is done offline and no formal record appears to be kept. While we could review each property to reproduce the original exercise and confirm the reported numbers, we suggested that the visibility could be improved by capturing all the details in one document. All audit trails that we did follow appeared to be reasonable	Company will consider observations made about current checks.
6	Line 21	Adequacy of procedures or methodology	The Company has not been systematically compiling evidence for the days that it is excluding events in Line 21. The Company is however able to retrospectively gather and present the evidence to confirm the validity of its exclusions.	Action is not necessarily required, but would make auditing easier in future years.
6	Blocks A to I	Not in line with RRs	We challenged the Company about its practice to deduct the total number of exclusions from the events reported in Blocks A to H, which was a misinterpretation of the guidance for completing the lines.	The Company concurred and adjusted its figures prior to submission.
7	Internally metered properties	Adequacy of procedures or methodology	Challenged Business Objects approach that had assumed all internally metered properties were domestic.	An exact split was not possible this year as the year end in Hi-Affinity had passed, but a commercial/domestic split taken from the current customer base was used which is sufficiently accurate for JR11.
7	Internally metered properties	Adequacy of procedures or methodology	The number reported is simply a reflection of what has been identified by meter readers on their rounds. This number is likely to continue to rise over the next few years as internal meters continue to be found	Accepted – no action is feasible and this should just continue to be noted to Ofwat.
7	Categorisation procedures	Adequacy of procedures or methodology	We interviewed the new property team to review the procedure for allocation of D,C,M codes for new properties or upon change of property type. We found that allocations of properties into domestic, commercial and mixed generally follow Ofwat guidance, but there is no written note or procedure for doing this, so mis-allocation by inexperienced staff is possible.	Company has produced a procedure document that is now held by the new properties team.
7	Demolished/redeveloped properties	Assumptions used	Currently there is no reconciliation with Address Point on GIS and demolished properties are only removed from the billing system when the Company finds this out for themselves (usually through meter readers). The number of 'void' properties is probably therefore slightly over-reported.	Company is carrying out a GIS reconciliation on total property numbers, which should be available for JR12.
8	Line 7	Not in line with RRs	Line 1 was reported as 0 but as figure refers to meters put on charge within the preceding approx 12 months (i.e. partly while the scheme was still running), that the figure should be reported.	Company revised Line 1. This would have been a material issue was resolved prior to submission.
8	Line 6	Assumption used	The Ofwat definition of more than '3 months' is interpreted as 93 days in generating Line 6 figure. By changing the assumption to 90 days, the Line 6 figure increased to 250 from 227. This is a 10% increase on Line 6 and a 0.3% increase of total number of meters installed.	There is no confidence grade for this Table and it is difficult to say whether this issue is material. While we believe 93 days is a generous interpretation of '3 months', for consistency of reporting, the Company may wish to leave the assumption as it is.

10	DI – Debden Road	Error	The adjustment for Debden Rd process seems to be a time series that has been inappropriately copied from previous years into the DI spreadsheet.	Minor error – not material. Will be amended for next year
10/10b	DI – bulk meter accuracy and coverage	Adequacy of procedures or methodology	We challenged the adequacy of the remaining DI bulk meter coverage and calibration, to ensure there are no more adjustments required like Clay Lane or the Anglian import that might significantly affect the reported figure. We noted that there is a 24Ml/d discrepancy in Table 10b between abstraction and DI meters overall.	Company provided some evidence and it is unlikely that there is a significant issue, but reconciliation between abstraction and bulk DI meters should be reviewed in future.
10	uPCC	Adequacy of procedures or methodology	The 2008 Leakfrog survey identified properties on this monitor with existing leaks and reduced PCC accordingly. However, it is noted that this is a 'snapshot', and PCC will tend to trend upwards as new leaks occur (although properties >750l/d are investigated via meter reader 'PUI' checks).	None required for JR11, however, this needs to be considered as part of the JR12+ water balance review.
10	uPCC	Adequacy of procedures or methodology	Overall adjustments for ACORN – **item covered in main report text.**	
10	Leakage calculation – 'red zone' exclusions	Adequacy of procedures or methodology	Whilst the majority of the exclusion are well managed and recorded, we found that there has been some inconsistency in the 'red zone' reporting for DMAs within the Arkely and north London zones. These were reviewed by the Leakage Verification Manager after the relevant zonal manager had left, and updates were made, but these have only been noted on the monthly summary sheet that is held by the Leakage Verification Manager. They have not therefore been noted on LMARS or included in the transposition of the weekly red zone reports that have been used as the basis of the reported leakage figures.	Improvements required, but not material. Ensure that all red zone exclusions are noted on LMARS in accordance with the procedures in future years.
10	Leakage – 'passive' property adjustment	Adequacy of procedures or methodology	**Item covered in main report text.**	Being reviewed as part of leakage reporting initiative.
10	Void Properties	Assumption used	Around 12,000 properties have been re-allocated as occupied (but unbilled) following a Scorex review of financial activity at the unoccupied properties indicated through Hi-Affinity. Whilst there is some uncertainty about the exact status of these properties (some may just be used as billing/transaction addresses), it is unlikely that this is significant and the impact on the water balance is minimal (<0.5Ml/d). Overall we consider that the change is justified	None required.
10	Household Night Use	Adequacy of procedures or methodology	**Item covered in main report text.**	Adjustments made prior to submission

10	Non HH Night Use	Adequacy of procedures or methodology	We challenged this adjustment on this basis of the age of the supporting empirical model relationships. However, on further review it appears that the supporting models are reasonably current, although exceptional use metered coverage is somewhat out-dated. The re-basing of the exceptional use NHH users effectively reduces leakage by around 4Ml/d. We note that the figures used for the 'assessed' metered properties are conservative and the adjustment appears to be reasonable.	Currently justified, but exception use needs to be reviewed and further logging carried out at some point.
10	Billed measured volumes	Adequacy of procedures or methodology	This figure is relatively sensitive to the accruals calculation that is used within the Hi-Affinity report. This has been reviewed by PwC and the error is around 5%, which is within confidence grade.	Further investigations and improvements are being considered as part of the leakage reporting initiative.
10	MLE adjustments	Adequacy of procedures or methodology	Based on the above uncertainties, we challenged the percentage uncertainty used for distribution losses within the MLE calculation. Simple additive evaluation of the uncertainty factors showed that this is likely to be close to 10%. Other minor components were also challenged, as uncertainties were clearly too low.	Distribution losses uncertainty changed to 10% in the MLE spreadsheet. Water taken unbilled and dist. system ops use uncertainties increased to 50%.
11	Excluding ferrules from Mains Bursts.	Adequacy of procedures or methodology	The Company has spent a significant effort to ensure that it excludes any types of repairs on mains that can be excluded under the Ofwat Reporting Guidance, namely ferrules, for which it is commended. However we consider that the Company should also show demonstrable efforts to ensure that it is including anything that should be counted as a burst main repair. For example perhaps it should run a report against all jobs that are raised as a mains burst job and closed under a non-mains burst job code to demonstrate that all appropriate jobs are being recorded. This is very unlikely to be a material issue.	The Company will consider carrying out an inclusion review for JR12.
11	Ferrule leaks.	Unexplained trend	Ferrule leaks are now excluded from the mains burst figures. We challenged the Company as to why the number of ferrule repairs was trending upwards.	The Company responded that historically it carried out a large number of comm pipe replacements and as part of this it would opportunistically repair any ferrules. It has now moved away from this and only carries out repairs where required.
11	Mains renewed	Assumption used	We noted the internal audit committee report relating to a potential change to a confidence grade of B2 for this line. We do not consider that the length renewed is in question, as this is the subject of QS/cost checking as part of the contract. We also consider that upsizing of mains for growth is legitimate to include where this involves replacement of the existing main (i.e. this is in line with Reporting Requirements). Upsizing and minor alterations to the network that are carried out to provide a similar, but improved/more operationally flexible version of the connectivity that already exists within the	Company reviewed and maintained CG, which we consider to be reasonable.

			system is common practice 'good engineering' and are, in our experience, legitimately included within this reported figure. The only concern therefore relates to any clearly identified extensions that have been carried out during the mains renewal project activities that have significantly changed the connectivity and capacity of the system. In practice this is very unlikely and can be remedied through simple liaison with MACE.	
11a	Line 5	Unexplained trend	Increase in number of unplanned maintenance activity - **item covered in main report text.**	See Board Overview
11a	Line 5	Not in line with RRs	Confidence Grade - **item covered in main report text.**	CG amended prior to submission
11a	Line 5	Change in methodology	Change in turbidity relates to sample tap refurbishment rather than actual trends, and there has been a stepped methodological change in leakage. The Company has been working to a serviceability plan and investigations pointed towards the sample lines being the issue for which it obtained funding to rectify. VCE was always confident that there was not an inherit issue with turbidity of coliforms or turbidity as inline monitoring suggested that there was no issue.	Comments made in main report text.
12	Decrease in number of works.	Not in line with RRs	For JR10 the Company reported 89 works. For JR11 it is reporting 83 works. This is due to a change in reporting after clarification from Ofwat. Previously the Company reported the number of bulk imports as works. The Company is now correctly excluding these. The Company has not commissioned any sites in 2010/11 and the number of works that should have been reported for JR10 is 83.	Comments made in main report text
21	Table 21 Reconciliation of customer services costs between table 21b and Table 21	Not in line with RRs	We noted that the Company had sought to provide consistency between accounting separation cost allocation and Table 21. However, we noted that in relation to customer services aspects of retail costs in Table 21b that costs related to network issues should consistent with Ofwat definitions be allocated to direct costs water distribution in Table 21. Thus we would not expect to see Table 21b retail costs reflected in full in Table 21 customer services costs.	The Company told us the cost centre has always been seen to be purely a customer services cost and in all previous JR's has been reported under customer services. This is reinforced by the need to report in 21b, line 10. The majority of the costs will be employment costs as this is the call centre. The movement would be approx £0.4M. The Company has not revised its allocation and is consistent with JR10 reporting
21	Minor errors	Not in line with RRs	Minor errors relating to customer side leaks and allocation of charitable trust donations were identified.	The Company revised its submission to bring it into line with RRs
21, 21a	Table 21 and 21a Apportionment of power costs between business units	Assumption used	We queried why power costs had been apportioned between business units on the Table 12 pumping head analysis rather than on actual site metered costs. We thinking pumping head is appropriate where a site covers more than one business unit and sub-meter analysis is not available.	The Company explained that it was being consistent with JR10 but would review the issue for JR12. It stressed that consistency needs to be maintained between table 12 and 21.

21	Table 21 Raw water Distribution Costs	Not in line with RRs	**Item covered in main report text.**	The Company has amended its submission to correct this misallocation. It told us that from the direct cost spreadsheet the amounts that were generated by the Distribution reports have been reallocated to R&T on the table. Most of the cost is power. Some £2.5m has been reallocated as a result.
21	Table 21 Treatment of severe weather costs	Assumption used	**Item covered in main report text.**	Costs are mainly related to leakage, and a supporting cost breakdown was provided.
21b	Table 21b Allocation of scientific services costs to retail	Assumption used	In the context of Table 21b we asked if the Company could confirm that there are no scientific costs associated with non-household retail, for example schools	The Company responded that Scientific services are checking to see if they can extract any non-household data. However, they may be a system limitation here which prevents this. The company said that over 99% of the reads they do are at domestic properties and thus they are comfortable that they are not significantly misstating the balances. There is no change to JR11 arising.
CCD – Tables 25a/c, 33 & 34	Calculations used for CCD	Error	We checked calculations and reconciled back to the FAR/PA outputs as appropriate and found no significant errors, apart from column W of the three CCD calculation worksheets. This was relatively significant, but was amended prior to submission.	Calculations corrected prior to submission.
CCD – Tables 25a/c, 33 & 34	Procedures	Adequacy of procedures or methodology	The procedures documents are very high level for what is, essentially, a fairly complex, spreadsheet based process that involves numerous interim stages. Some changes were agreed at audit to reflect the processes that are used (particularly in relation to the review of asset lives).	Amendments were made to the reporting procedures.
CCD – Tables 25a/c, 33 & 34	'Ofwat' asset code allocation	Adequacy of procedures or methodology	It was noted that many of the 'Ofwat' T32 allocation codes change from year to year within the CCD calculation worksheets. The exact reason for this is not clear, but it is caused when projects >£250k spend are being reviewed for the JR process or are being 'split' within the PA database. Audit checks showed that a very small number of assets changed between base and enhancement codes, so this is not a material reporting issue.	Accepted – it may be advisable that the procedures formally require a check against previous years when codes are being changed or updated.
CCD – Tables 25a/c, 33 & 34	AMP MEAV adjustment and reconciliation with the PR09 Business Plan	Assumptions used	**Item covered in main report text.**	Comments on the impact of the MEAV revaluation have been provided in the main body of this report.
Table 33	Project start dates	Adequacy of methodology	**Item covered in main report text.**	Company will strengthen procedures as part of the move to the new Oracle reporting system.

Tables 32, 35 & 37	Allocation of programme overheads.	Adequacy of procedures or methodology	Challenged allocation of programme management overheads, procurement costs and MACE contractor fees. The only non-trivial exception that was noted is that the MACE contractor costs have been allocated on a spilt calculated for last year's activities. However, this has resulted in the management costs being allocated to enhancement categories such as bromate treatment, where there is actually no work within AMP5	Company accepted that this was error, but it was too late to modify within the reported accounts. The size of the error has been commented upon in the main body of this report.
Tables 32, 35 & 37	Spreadsheet controls	Adequacy of procedures or methodology	Some errors were noted in the manual calculations used within the 'tables & calcs' spreadsheet and there is no record of the spreadsheet checks that are carried out for the JR reporting process. An error in the application of the infra/non-infra split was also noted. We noted that code S33, which is entirely allocated to infrastructure, included 'screw in meters' for developer services.	The table calculation spreadsheet was corrected prior to submission. The Company will consider including notes of checks carried out on the spreadsheets. Corrected prior to submission.
Tables 32, 35 & 37	Procedures	Adequacy of procedures or methodology	As with other financial capex tables, the procedures document was relatively high level and concentrated on data sources, risks/controls and outputs without actually detailing the process that is used..	Procedures were updated prior to submission.
Tables 32, 35 & 37	Capitalisation policy	Adequacy of procedures or methodology	We noted that the capitalisation policy is quite high level and does not indicate what actually tends to happen for projects that involve grouping of smaller items <£5000 in value (e.g. minor maintenance 'catch all' codes). However, we did query this with the financial auditors, who indicated that capitalisation is generally appropriate in their view, so this is not a material issue.	Improvement in policy may be considered.
35	Tables 35 and 37: Opex Methodology	Adequacy of procedures or methodology	Need to maintain up to date methodology within a controlled environment to meet Ofwat JR11 reporting requirements.	Company updating methodology prior to JR11 submission
42	Confidence grades	Not in line with RRs	**Item covered in main report text.**	CGs amended prior to submission

4. Annex A: General Information

This General Information annex is to be considered commercially confidential and has been removed from the public domain version of the Reporter's report.

5. Annex B: Level of Service Certificate

5.1. Reporting Requirements

The reporter must comment on any discrepancies between the methodology described and that actually practised by the company. The reporter should pay particular attention to areas of the methodology that do not meet the reporting requirements and any changes in methodology or systems from the previous June return.

DG2 Pressure of Water Mains

The Company had updated its DG2 Levels of Service Methodology for the previous report year, but the methodology is unchanged for JR11. We did not identify any discrepancies between the methodology described and that actually practised by the Company.

DG3 Supply Interruptions

There have been no changes to the methodology for JR11. The Company has a well documented internal process for the management of DG3, which matches the reporting requirements and is, to the extent revealed by our audits, followed by the Company when reporting for the June Return.

DG4 Restrictions on the Use of Water

The Company did not invoke any DG4 Restrictions during the Report Year, but has a reporting system that is in line with the Reporting Requirements when needed.

DG6 Response to Billing Queries

The reporting system remains the same as that used in previous years. It is comprehensive and followed during the reporting process. It is largely in line with Reporting Requirements, however we note the issue associated reporting of contacts received on the weekend, as detailed in the main body of this report and referred to in the Company Board Overview. This has been disclosed previously within the Levels of Service Methodology, but it may have been interpreted as just relating to e-mail contacts, whereas in practice it relates to all contacts received.

DG8 Billing of Metered Customers

The methodology has not been changed since JR10. It is appropriately documented and in line with Reporting Requirements. We did not encounter any material exceptions to the procedures during our audits for JR11. We note that we have made a minor recommendation relating to the potential improvement of the query used to identify combination meters, but this does not affect the reported confidence grade.

5.2. Reporter's Levels of Service Information Certificate

LICENCE CONDITION J

LEVELS OF SERVICE INFORMATION CERTIFICATE

I refer to the documents dated June 2011 prepared by Veolia Central Water as the June 2011 return to the Water Services Regulation Authority, which have been reviewed under my direction.

The June return, for which Veolia Central is solely responsible, includes Condition J (of the Instrument of Appointment) Levels of Service information.

In my professional opinion, based on and to the extent disclosed by sample monitoring carried out and as described in my Report to the Authority dated 17th June 2011:

1. the June return, in so far as it relates to Condition J Levels of Service information, has been properly compiled by Veolia Central, and in accordance with reasonable methods and procedures which are adequate for providing information to the appropriate degree of accuracy and to enable the Authority to make a fair assessment of the company's performance against Levels of Service indicators; and

2. subject to the qualifications expressed in my Report referred to above, the June 2011 Return, in so far as it relates to Condition J Levels of Service information, has been prepared in accordance with the methodologies described in the submission dated June 2011 to the Authority and that these methodologies are adequate for the purpose of obtaining Levels of Service information in accordance with the relevant reporting requirements.

3. in reviewing information and materials for my report I was not required to review information and materials for the SIM.

Signed
For and on behalf of
Atkins Limited

17th June 2011

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