Targeted Review of Accounting Separation Cost Allocations

Report of findings

28 May 2013

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Private and confidential
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28 May 2013

Dear Andrew

Targeted review of accounting separation cost allocations

In accordance with Services Order SER/0335 dated 3 January 2013 we present our report on the results of the targeted review of accounting separation cost allocations. This transmittal letter forms part of the document.

Purpose of our report and restrictions on its use

This report was prepared on your specific instructions solely for the purpose of this engagement and should not be relied upon for any other purpose. We acknowledge that Ofwat intends to publish this report, subject to certain agreed redactions. Ernst & Young LLP assumes no responsibility whatsoever in respect of or arising out of or in connection with the contents of this report to parties other than Ofwat. If others choose to rely in any way on the contents of this report they do so entirely at their own risk.

Scope and nature of our work

The scope and nature of our work are detailed in sections 1 and 3 of this report. Our report to you is based on the information made available to us. We have not reviewed any source documentation or audited the information and explanations with which we were provided. Our procedures did not intend, or seek, to express an audit opinion on the information and, therefore, do not constitute an audit and should not be relied on as such.

Our report

Whilst each section of the report addresses different aspects of the work we have agreed to perform, the entire report should be read for a full understanding of our findings and advice. We shall be pleased to discuss the findings set out in this report with you. If you have any queries regarding our findings please do not hesitate to contact me.

I would like to take this opportunity to thank both Ofwat and the water companies for their assistance with the review.

Yours sincerely

Jonathan Middup
Partner
For and on behalf of Ernst & Young LLP

Abbreviations and definitions

Abbreviation	Definition
ACTS	Average Cost To Serve
Business Units	The nine business units defined by Ofwat in 2009/10
BWBSL	Bristol and Wessex Billing Services Limited
CCA	Current cost accounting
CCD	Current cost depreciation
CTS	Cost To Serve
Draft Water Bill	Draft Water Bill presented to Parliament July 2012
FRS 5	Financial Reporting Standard 5
GIS	Geographic Information System
G&S	General and support
HCA	Historic cost accounting
June Return	A series of tables prepared by the companies' and submitted to Ofwat. The last June Return submission was for the year to 31 March 2011
M&G	Management and general
MEAV	Modern Equivalent Asset Value
Methodology Statement	A statement required to accompany accounting separation data reported in 2009/10 and 2011/12.
PR09	The price review undertaken by Ofwat in 2009
Regulatory Accounts	Annual financial statements for the regulated business of the water companies
Reporter	Independent reviewer of data reported in June Return and PR09
Retail Table	Activity costing analysis table 2: retail services
ST6	Analysis of fixed assets by business unit: retail service
ST7	Analysis of meter assets: retail service
WaSC	Water and Sewerage Company
Water companies	All WaSCs and WOCs
WOC	Water Only Company

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1. Executive summary

1.1 Context

Ofwat introduced accounting separation in 2009/10. This represented a step change for water and sewerage and water only companies. At the time of the review, the 21 companies had completed three years of reporting disaggregated cost information. As part of its industry reforms Ofwat intends to set separate retail and wholesale price controls from 2015. The accounting separation information reported by companies provides a key input to these price controls.

Ofwat has commissioned this targeted review of accounting separation cost allocations in response to concerns it identified with the robustness of the reported information. Furthermore, Ofwat considers that now is an appropriate time to take stock of the progress that has been made.

The objective of the review is to provide Ofwat with the information that it needs to make future reporting requirements in relation to retail costs fit for purpose and for it to have confidence that future retail cost data reported by companies is robust and any inconsistencies are appropriate and justifiable.

The review has sought to understand whether there is any evidence to support Ofwat's concerns and, if there is, to quantify the potential impact on retail price controls. This quantification is based on the potential impact on each company's own Cost To Serve (CTS) and the overall Average Cost To Serve (ACTS). Whilst retail costs make up a relatively small proportion of total cost they are considered material because they form the basis of the calculation of CTS and ACTS.

Based on information reported by companies in 2011/12 and adjusted to exclude certain activities per Ofwat's methodology consultation, CTS ranged from £13.81 to £51.35 per unique customer, ACTS was £29.31. This is based on a model provided by Ofwat to illustrate the potential impact of retail cost inconsistencies on CTS. Ofwat's policy on the calculation of ACTS remains subject to consultation.

The need for the review has been reinforced by responses to Ofwat's *Future Price Limits* consultation where various stakeholders, including companies, potential market entrants and investors raised concerns over the accounting separation data. The concerns raised covered a lack of transparency and consistency in company approaches to cost allocation and the effect of different policies on revenue recognition.

In approaching the review we have considered the range of potential outcomes. Addressing the concerns that have been raised requires an understanding as to whether there are underlying issues with the quality of the reported data (i.e. it does not represent the actual costs incurred in the retail business unit) or whether the data is generally robust and the concerns result from the perception of the quality of the data.

We note that for 2009/10 and 2011/12 companies were required to publish an accompanying commentary but that this requirement was removed in 2010/11 before being reintroduced. We consider that this inconsistency is likely to have contributed to concerns that have been raised by companies over the reported information.

1.2 Approach to the review

The approach to the review was designed to reveal differences between the ways companies recognise and report financial information and to assess whether reported data is robust, comparable and transparent.

In conducting an exercise intended to reveal differences between the ways companies recognise, record and report financial information, we considered that a 'targeted review' focused on the likely areas of difference the most effective approach. The approach was informed by our own experience in the water sector and other regulated industries, from information provided by the companies and from performing data analysis.

The review has focused on the boundaries between the retail and wholesale business units (using Ofwat's preferred definition of retail as set out in its price review methodology consultation) and between household and non-household customers.

The work that we performed in undertaking the review consisted of the following stages:

- **Stage 1:** Initial review and identification of target areas and request and review of initial information from all companies.
- **Stage 2:** Meetings with all companies to investigate target areas, individual company's concerns and to discuss each company's retail business structure. Following the meetings a series of follow up questions were asked to support explanations provided in meetings and to respond to specific points raised. The site visits in stage 2 were undertaken between 22 January 2013 and 4 March 2013. As the programme of meetings progressed additional matters of potential significance were identified and it was necessary to revert to some of the companies previously visited to gather further information.
- **Stage 3:** Evaluation of information and illustrative quantification of the impact on individual companies' CTS and overall ACTS.
- **Stage 4:** Provide recommendations for actions to make future reported information more robust, transparent and comparable.

Given the possible outcome that the data reported in the Retail Table was largely robust our approach did not include detailed transaction testing or audit procedures; such an approach would not have been proportionate and, in our view, would not necessarily reveal all areas where the data was not robust or consistent. Had the findings of the review showed that the data was not robust, comparable or transparent then we would have sought to perform focused transactions testing in order to quantify the impact on CTS and ACTS.

1.3 Cooperation from companies

We would like to place on record our appreciation for the cooperation of the companies during the review. To a large extent the findings in this report and associated recommendations have been drawn from the information and explanations provided to us. We are grateful for the openness and honesty with which companies have approached the review and have engaged with us.

We would also like to thank Ofwat for their assistance throughout our joint work on the review.

1.4 Findings

While the review has identified areas where the robustness, comparability and transparency of the data could be improved we note and recognise that there is much that is working well.

An important finding from the review is that costs which are incurred by companies in delivering core customer service activities (those activities that were previously reported as Customer Services in the June Return) are in the main robust and comparable.[1] The costs associated with these activities are recorded directly to retail cost centres and are monitored

[1] Where we refer to core customer services we are referring to the following services: Billing, Payment handling, remittance and cash handling, Debt management, Doubtful debts, Non-network customer enquiries and complaints and Meter reading.

on a regular basis. Company customer services directors' (or equivalents) performance is often measured by reference to these costs.

The costs incurred by companies in delivering core customer services account for over 60% of the total costs and around 75% of total direct costs reported in the Retail Table (including doubtful debts).

Away from the core customer service activities the review has identified:

- Matters where the information that has been reported is not robust or comparable;
- Inconsistencies in the way in which certain costs are recorded which affect comparability; and
- Differences in the information that has been disclosed by companies to enable the user of the information to make informed comparisons and judgements.

The impact of these differences on CTS and ACTS is small.

It is important to note that even after the matters identified during the review have been addressed the data reported on a comparable basis is still likely to exhibit substantial differences between the levels of cost reported by companies. These differences can result from factors such as:

- Company size and retail business unit structure
- Meter penetration
- Demographics
- Efficiency and productivity

1.4.1 Matters where information is not robust or comparable

Costs relating to activities included in retail business unit that are not part of the core customer service activities (e.g. network customer enquiries and complaints) often have to be disaggregated from wholesale activities to be reported in the retail business unit. In addition general and support expenditures are not allocated to retail business unit activities as a matter of course and therefore require a manual allocation process.

Where manual intervention is required the resulting reported information may be (or may be perceived to be) less robust. In a number of company meetings we identified costs that had not been allocated to the retail business unit in error, in particular with respect to scientific services, other business activities and general and support activities. The impact of these omissions is, on average, around 2% of total retail costs.

Of particular concern is the robustness and comparability of capital maintenance costs (principally current cost depreciation). Most companies were not able to clearly explain their approach to reporting capital maintenance costs and in certain cases there were omissions in the assets that had been allocated to the retail business unit. On average total capital maintenance charges make up 10% of reported retail costs (excluding meters). Where omissions were identified the impact on total retail costs was less than 1%.

1.4.2 Inconsistencies in the way costs are recorded affecting comparability

The review identified inconsistencies in the allocation of costs to retail in respect of certain activities that sit on the retail-wholesale boundary and business support activities. The costs of these activities represent less than 10% of total retail costs reported in 2011/12. In certain instances the inconsistencies result from companies not following existing guidance, in others we consider existing guidance to be unclear, as follows:

2011-12 guidance is clear

- Five companies did not include the costs of investigatory visits (including scheduler time) in retail. The average cost per unique customer for companies that did include this in retail was £0.44.
- One company reported no costs relating to 'Customer side leaks' and one company reporting its costs as 'Other direct costs'.
- In certain instances local authority rates were included as general and support expenditure rather than separately as required. This has no impact on total costs allocated to retail.

2011-12 guidance is unclear

- Eight companies did not record the cost of scientific services in retail and there were differences in interpretation as to whether routine sampling at customer taps was a retail activity. The average cost per unique customer for companies that did include this in retail was £0.44. The cost of other business activities (mainly regulation) has been allocated to retail based on the number of business units. Previous guidance stated that retail was considered to be one business unit however some companies considered it to be two (household and non-household) thereby increasing costs allocated to retail.
- The cost of insurance has been recorded by some companies within G&S expenditure and other companies within other direct costs. This has no impact on total costs allocated to retail.

Revenue recognition

With regard to revenue recognition the review did not identify any instances where companies chose not to issue bills to known occupiers with a history of non-payment. The review identified two areas where companies followed different practices relating to doubtful debts, as follows:

- Where the occupier of a property is unknown but there is evidence that the property is inhabited, ten companies issue bills in the name of the occupier ('The Occupier') in order to ascertain the name of the occupant whereas others do not. For those companies that were able to quantify the proportion of the doubtful debt attributable to bills being issued to The Occupier the maximum impact on CTS was £0.13 per unique customer (less than 1% of CTS). Companies that were not able to quantify this stated that the value of bills raised to The Occupier was minimal.
- Where a company is unable to collect debtors as a result of an occupier leaving the premises without notifying them one company stated that, for unmetered properties, any doubtful debt is reduced to account for the possibility that the occupier left the property some time prior to the date of 'new' occupation and was therefore void for a period. The impact was to reduce that company's CTS by £0.27 (1% of CTS).

General and support expenditure

General and support expenditure, which on average makes up 10% of companies' CTS, is not consistently identified and allocated to the retail business unit, specifically:

- Overhead costs being reported in general and support expenditure which other companies reported as direct costs. This has no impact on total costs allocated to retail.
- Costs in relation to certain general and support activities being erroneously omitted from the retail business unit. For those companies that had omitted costs the maximum impact was to reduce CTS by £0.14. In addition one company had over allocated

general and support expenditure to the retail business unit. The impact was to increase that company's CTS by £0.20.

- Most companies used a cost driver based on employee measures to allocate categories of general and support expenditure to retail. Although the cost drivers that were used were not consistent the review did not identify any apparent over or under allocation of costs to the retail business unit. We agree with Ofwat's current guidance that allows companies discretion in the selection of cost drivers however, for comparative purposes, we consider below the use of a standard metric to perform an alternative calculation as part of the business plan process.

Household and non-household customers

- Most companies used cost drivers based on customer measures to allocate retail costs between household and non-household customers (e.g. number of customers in each category, number of bills). Whilst cost drivers used are broadly similar across the sector the availability of information has resulted in differences in the exact measure used to allocate costs. We agree with Ofwat's current guidance that allows companies discretion in the selection of cost drivers however, for comparative purposes, we consider below the use of a standard metric to perform an alternative calculation.

1.4.3 Differences in the information that has been disclosed

The primary source of transparency over the reported accounting separation data is the Methodology Statements that have been reported by the companies in 2009/10 and 2011/12. Review of the companies' Methodology Statements shows that there is a wide variety in both the nature and quantity of the information disclosed.

Those Methodology Statements we considered to be most helpful included descriptions of the organisational structure of the company's retail operations (four companies), the governance process applied in approving the accounting separation tables (16 companies) and included analytical review style commentary to explain costs incurred (four companies). Such information enhances users' perception and understanding of the reported information.

A total of 17 companies detailed the cost drivers that had been used to allocate costs between retail and wholesale and between household and non-household customers however the level of detail varied significantly, in particular with regard to general and support expenditure. Consistency in the level of detail provided would increase the comparability of reported information.

1.4.4 Impact on retail costs

We have calculated the impact of the net inconsistencies identified during the review on CTS and ACTS.

The impact on CTS and ACTS is dependent on the assumption that is made as to whether the costs of investigatory visits following 'Network customer enquiries and complaints' is included or excluded from the retail business unit. On the basis that it is included the impact on CTS and ACTS of adjusting for all inconsistencies is as follows:

- The maximum impact on an individual company's CTS is to increase it by 4% with the average impact on CTS being an increase of around 2%. Four companies' CTS were unchanged and no companies' CTS were reduced.

- ACTS based on reported information was £29.31 per unique customer, following recalculation as a result of the review this increased by £0.57 to £29.88 per unique customer, an increase of 1.9%.

1.5 Recommendations

We have proposed a series of recommendations based on the findings of the review. The thrust of these recommendations is to address the inconsistencies which affect the comparability of reported data through clarification of guidance and to improve the perception of the robustness of reported data through assurance and disclosure. We believe that these recommendations are consistent with Ofwat's risk based approach to regulatory compliance.

1.5.1 Assurance

To address concerns that data is not robust we propose that assurance is given over the reported accounting separation by company management (internal assurance) and by company auditors (external assurance).

Internal assurance

Mechanisms to provide internal assurance are already in place through director approval of the regulatory accounts (from 2012/13) and the authorisation of the risk and compliance statement. We recommend that, in company specific letters to be issued following completion of this review, Ofwat draws companies' attention to the fact that it considers the Retail Table to be important and reminds companies of their obligations in this regard.

External assurance

The mechanism to provide external assurance is through the audit opinion given over the regulatory accounts. As set out in Information Notice 13/01 the accounting separation tables are to be included in the regulatory accounts in 2012/13. Although Ofwat has emphasised the allocation of costs and fixed assets between wholesale and retail is considered to be material the opinion that is given by the auditor will refer to the accounts as a whole.

To increase assurance over the data we recommend that specified agreed upon procedures are developed and applied from 2013/14. The agreed upon procedures would focus on confirming the Retail Tables were prepared in accordance with the Methodology Statement, agreeing cost information to company financial systems and reviewing cost allocation calculations.

The nature of the Retail Table is such that it would not be appropriate to request companies obtain a separate audit opinion, as the base information used to prepare the Retail Table is already subject to audit as part of the regulatory accounts. Performance of agreed upon procedures will augment the overall audit opinion given on the regulatory accounts.

1.5.2 Guidance

Our proposed recommendations in relation to guidance are based on whether we consider current guidance is clear but is not being followed or where guidance could be clarified.

To address findings in relation to the comparability of data where current guidance is unclear we recommend that Ofwat issue guidance to clarify:

- Insurance costs should be included in general and support expenditure.
- The types of sampling activity that should be included within retail.
- Whether retail is one business unit or two.

For other areas where the review has identified companies not following Ofwat's accounting separation guidance (for example in the way local authority rates and costs of customer side leaks are recorded and the inclusion of the costs of investigatory visits) or where the review identified minor omissions or errors (specifically with regard to fixed assets) we recommend that Ofwat address these on a one to one basis with the relevant company.

1.5.3 Disclosure recommendations

With regard to the transparency of the information that has been reported we recommend that further disclosure is given in the Methodology Statement (in addition to the minimum requirements set out in Information Notice 13/07) in relation to:

- An overview of the underlying business structure of the company's retail business unit, outsourced functions including agreements with other water companies and local authorities (including stating where outsourced functions are performed overseas) and the treatment of related overheads (whether they are included in overheads or direct costs) and stating the percentage of direct costs that relate to overheads.
- With regard to revenue the amount of revenue recorded where the risk of bad debt has been assumed by a third party, the amount of revenue and doubtful debt resulting from bills being raised to the occupier and the value of credit notes given in respect of properties deemed to be void when the date the previous occupier left is not known.
- Analysis of costs included in other direct costs and exceptional items.
- An analysis of general and support expenditure divided into consistent categories (HR, IT, finance, shared director costs, facilities and shared premises costs, insurance and other). The analysis should disclose the amount directly attributed to retail and the cost driver used to allocate the balance between retail and wholesale.
- The types of local authority rates and the basis of their inclusion in the Retail Table.
- An analysis of assets allocated to the Retail Table disaggregating the net book value and current cost depreciation between the billing system, other assets specifically allocated to the Retail Table and shared assets allocated to the Retail Table (detailing the basis of such allocation). The Methodology Statement should also disclose whether the company maintains a CCA register, the extent to which it is reconciled to the HCA fixed asset register and the methodology and assumptions used to compile CCA data.
- A list of cost drivers used to allocate costs between household and non-household customers.

Where current guidance permits discretion in the choice of cost driver (the allocation of general and support expenditure between wholesale and retail after directly attributed costs have been allocated and the allocation of retail costs between household and non-household customers) in order to enable Ofwat to make comparisons we consider companies should be required to present an allocation on an alternative prescribed basis (after directly attributed costs) within their business plans (and not on an annual basis in the regulatory accounts). The proposed cost drivers we recommend are:

- Allocation of general and support costs between retail and wholesale: Full Time Equivalents.
- Allocation of retail costs between household and non-household customers: Number of customers.

1.5.4 Impact on previously reported data

Given the findings of the review our recommendations in relation to restatement of previously reported data are limited to:

- Affinity Water, where we consider accounting separation data for 2011/12 consolidated for all three of the former Veolia companies should be restated on the same basis as the 2012/13 reported information.

- For the five companies that did not include the costs of investigatory visits in the Network customer enquiries and complaints activity Ofwat should consider whether the impact of additional costs in 2011/12 should be disclosed by way of a note in the 2012/13 regulatory accounts.

1.6 Summary

The findings of the review therefore provide some evidence in support of the concerns raised. For the majority of companies we have identified adjustments to the reported retail costs information however, based on their impact on CTS and ACTS it is apparent that these adjustments do not significantly change retail cost information that has been reported.

The variable quantity and nature of information disclosed by companies is likely to have contributed to the perception that the data is not robust along with the removal of the requirement to publish a Methodology Statement in 2010/11.

Consequently we believe that the concerns that have been raised are as a result of the perception of the quality of the information that has been reported and a belief that the effect of the inconsistencies is greater than the evidence suggests.

2. Introduction

2.1 Context

The water sector in England and Wales has embarked on a period of significant change in response to proposed market reforms including the setting of separate retail and wholesale price controls. Underpinning the proposed reforms is the accounting separation data reported by companies since 2009/10. Producing accounting separation data was a step change for companies in 2009/10. Three years of accounting separation data has now been reported.

Ofwat has commissioned this targeted review of accounting separation cost allocations in response to concerns it identified with the robustness of the reported information. Furthermore, Ofwat considers that now is an appropriate time to take stock of the progress that has been made.

The need for the review has been reinforced by responses to Ofwat's *Future Price Limits* consultation where various stakeholders, including companies, potential market entrants and investors raised concerns over the accounting separation data. The concerns raised covered a lack of transparency and consistency in company approaches to cost allocation and the effect of different policies on revenue recognition.

From a cursory review it is clear that the depth of explanation provided by companies in their published accounting separation methodologies varies enormously. In addition, where information has been provided, differences are apparent in the drivers that have been used to allocate costs.

2.2 Objective and scope of the review

The overall objective of the review is to ensure that future reporting requirements are fit for purpose and to provide Ofwat with confidence that future data reported by companies is robust and any inconsistencies are appropriate and justifiable.

The scope of the review set out in the Invitation To Tender is as follows:

- *An examination of four aspects of the 2011/12 accounting separation data for each of the 21 companies that published disaggregated cost information for 2011/12, as follows:*[2]
    - *The appropriateness of individual companies' cost allocations, focusing on allocations of common/shared costs on the retail-wholesale boundary and also between household and non-household customers.*
    - *Consistency of cost allocations across the industry; and*
    - *The potential impact of inconsistencies on the Average Cost To Serve (ACTS); and*
    - *The appropriateness and consistent application of accounting policies.*

A detailed description of the work undertaken in performing the review is set out in section 3.

2.3 Information

The findings set out in this report are based on the sources and types of information set out in appendix B. During the course of our work we have requested and been provided with information and explanations which were subject to a process of review and challenge. We report our findings on the basis that the information and explanations with which we have been provided are complete and accurate.

[2] The 21 companies along with abbreviations used to identify them are set out in appendix A.

The review did not intend, or seek, to express an audit opinion on the information and, therefore, does not constitute an audit and should not be relied on as such.

The receipt of further information may cause us to qualify or amend the findings reported herein.

As part of the review meetings were held with all companies. Prior to, during and after the meetings the companies provided us with information and explanations regarding the costs reported in their Retail Table. A template of the Retail Table for 2011-12 data is attached at appendix C.

Limitations in relation to information

Not all companies were able to provide us with all of the information that we requested. Where we believe the information that has not been provided is of potential significance to the results of the review this is set out in appendix D.

At the meeting with representatives of the former Veolia South East (now Affinity Water) no information was provided in respect of that company as the relevant employees have left the new organisation.

2.4 Structure of the report

This report is set out in six further sections, as follows:

- Section 3 describes the approach taken in performing the review.
- Section 4 describes important considerations in comparing companies' retail business units.
- Sections 5 to 7 set out the findings of the review, the implications for average cost to serve and proposed recommendations in relation to future reported data. The findings of the review are categorised under the headings: Robustness, Comparability and Transparency.
- Section 8 sets out a summary of proposed recommendations.

3. Approach

3.1 Introduction

In this section, we set out the approach we have followed in performing the review.

In order to put the approach into context we first describe the purpose for which the accounting separation data reported in the Retail Table is to be used. We then set out our understanding and interpretation of the concerns that have been raised by Ofwat and stakeholders before providing a detailed description of the work performed and, based on the findings our approach to proposing recommendations. We then briefly describe the basis on which we have classified the findings of the review in sections four to seven.

Section 3.6 sets out a summary of information we have identified in other sectors that is of relevance to the review.

3.2 Intended use of data reported in the Retail Table

In 2009/10 Ofwat introduced accounting separation. All companies have now completed three years of reporting. We note that the initial guidance provided to companies in 2009/10 was reissued in 2010/11. The only change from 2009/10 was that Ofwat withdrew the requirement for companies to report their accounting separation methodology before reintroducing this requirement for 2011/12. For 2011/12, Ofwat's guidance consisted of definitions for each line in the accounting separation tables, but no guidance was given on appropriate cost drivers.

It is currently envisaged that Ofwat will use the accounting separation data to set separate retail and wholesale price controls in 2014. Furthermore it is envisaged that Ofwat will use different mechanisms to regulate retail prices for household customers and non-household customers. As part of the market reforms set out in the Draft Water Bill, new entrants will be encouraged to the water sector, and accounting separation data included in the Retail Table will be used by potential new entrants to help them make informed decisions.

The mechanism that Ofwat expects to use to regulate retail prices for household customers is ACTS. ACTS represents the average cost of providing retail services to household customers and is calculated using a model developed by Ofwat.

Simplistically, Ofwat's model calculates the CTS for each company by dividing total operating expenditure and current cost depreciation allocated to retail household customers reported in the Retail Table by the number of unique household customers. The ACTS is subsequently calculated by a weighted average (by number of unique customers) of each company's CTS. We note that Ofwat's policy in this area remains subject to consultation.

In order to quantify and illustrate the potential impact of the findings of the review on CTS and ACTS Ofwat has provided us with a simplified version of their model. The calculations included within this report are based on this model. Total retail costs used in the model are those which were reported in 2011/12 less costs relating to rows 9, 11, 13 and 14 as per Ofwat's methodology consultation.

3.3 Our interpretation of Ofwat and stakeholder concerns

Ofwat raised concerns regarding the robustness of the accounting separation data. We understand that companies also raised concerns with regard to a lack of transparency and the level of consistency in company approaches to cost allocation. This highlighted the risk that the reported data was not sufficiently robust for the purposes of retail price controls due to inconsistency of reporting between companies.

In considering the reasons for the concerns raised, there are two possible outcomes to the review:

- Firstly, there are underlying issues with the quality of the data meaning that it is not robust.
- Secondly, the data is in fact largely robust and concerns arise from perceptions of the quality of the data, a lack of understanding of how companies have prepared their data and how their cost structures might differ.

To determine which of these two outcomes represents the underlying situation we have sought to understand the extent to which the data reported for 2011/12 is **robust**, **comparable** and **transparent**.

In the context of the review, we have defined these terms to mean:

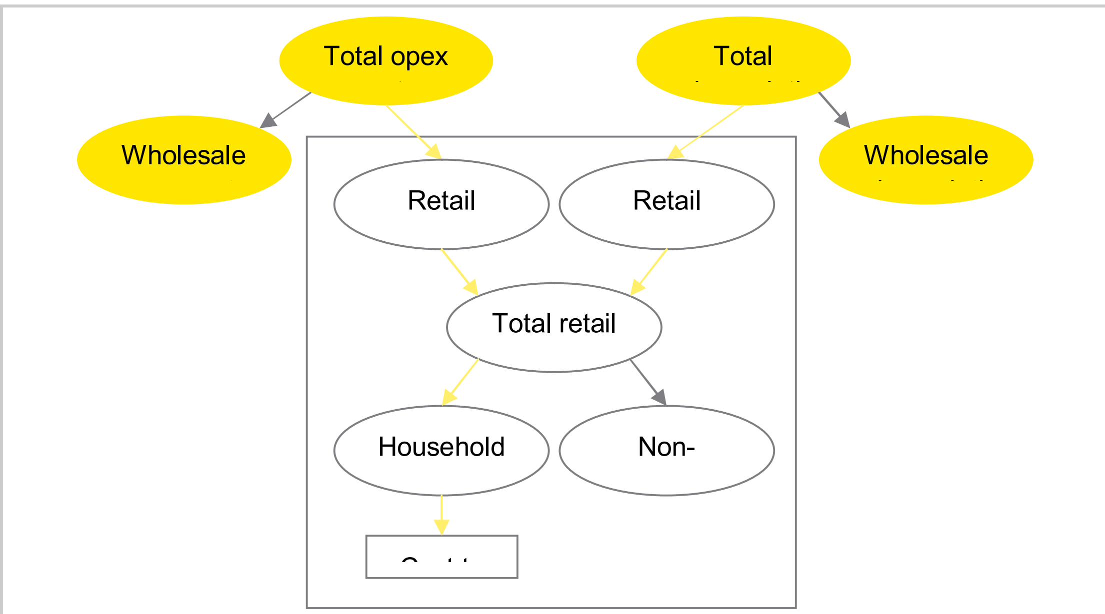
- **Robust:** The process companies follow to prepare and approve the Retail Table results in reported information which accurately reflects the costs incurred in performing the retail activities set out in the Retail Table.
- **Comparable:** Costs relating to similar transactions are recognised and reported in the same way by each company.
- **Transparent:** The information provided to users allows them to determine the extent to which the reported data is robust and to make informed comparisons and judgements between companies.

The work performed in undertaking the review, which is described below, was designed to address each of these points.

3.4 Work performed

3.4.1 Scope of the review

Before we describe the detailed work that we performed we set out diagrammatically the scope of the review and the way in which a company's CTS is related to its total operating costs in respect of operating expenditure (opex) and depreciation:



A key focus of the review is on the costs incurred on the retail wholesale boundary, the allocation of costs between household and non-household customers and the impact on CTS (shown as yellow arrows on the above diagram). Retail costs which are allocated to non-household customers are not included in the calculation of CTS.

3.4.2 Basis of approach and overview of work performed

As described in section 2.1 the review is described as a 'targeted review' of accounting separation cost allocations.

In conducting an exercise that is intended to reveal differences between the ways companies recognise, record and report financial information and assess whether reported data is robust, comparable and transparent, a 'targeted review' focused on the likely areas of difference is the most effective approach.

The approach seeks to identify areas where reported data is not robust or consistent through focused review and discussion. These reviews and discussions are informed by our own experience in the water sector and other regulated industries, from information provided by the companies and from performing data analysis.

Given the possible outcome that the data reported in the Retail Table was largely robust it would not have been proportionate to undertake detailed transactions testing. Should the findings of the review show that the data was not robust, comparable or transparent then we would have considered whether focused transactions testing was appropriate in order to quantify the impact on CTS and ACTS.

The work that we performed in undertaking the review consisted of the following stages, each of which is discussed further in this section:

- Stage 1: Initial review and identification of target areas
- Stage 2: Site visits to companies
- Stage 3: Evaluation of information and quantification of the impact on ACTS
- Stage 4: Recommendations

3.4.3 Stage 1: Initial review and identification of target areas

Preliminary analysis

At the outset of the review, Ofwat provided us with relevant information relating to each of the water companies, a list of which is set out at appendix B. During stage one, an initial review of this information was undertaken to identify areas to focus on in stage two. The work performed at this stage included:

- Data analytics on the retail costs reported in the 2011/12 Retail Table.
- A review of each company's accounting separation Methodology Statement to compare its approach and the cost drivers used to allocate costs to the Retail Table and between household and non-household customers.
- A review of the responses provided in respect of consultations was also undertaken to highlight any identified differences in approaches to allocation of costs to the Retail Table and between household and non-household customers.
- Application of our knowledge of the water sector and other regulated industries to identify areas of potential difference.

It was apparent from the results of this preliminary analysis that the approaches undertaken to prepare the table varied by company as did the cost drivers used to allocate costs to the Retail Table and household and non-household customers. Furthermore, the absolute values and percentages of costs which had been allocated to the retail business unit also varied significantly between companies. However, this did not mean that the data was not robust or comparable.

Pre site visit questions

In advance of site visits a set of pre site visit questions was provided to each water company. The questions asked covered both general questions around retail business unit structure, cost allocation methods, fixed assets and specific questions based on the results of the preliminary analysis.

The responses to the pre site questions were used to shape the agenda of the company meetings. No response was received in relation to the data reported in the Retail Table for Veolia South East (now part of Affinity Water) as the relevant individuals have left the new organisation.

3.4.4 Stage 2: Site visits to companies

Meetings were held with all water companies that produced accounting separation data for 2011/12 (in respect of the three former Veolia companies one meeting was held with Affinity Water). A standard agenda was developed for each meeting, a copy of which is attached at appendix E.

The meetings covered a series of topics including: organisational structure, process of preparation of the Retail Table, cost drivers and actual costs reported in the Retail Table. In addition to the standard agenda specific questions were asked based on the preliminary analysis. Following each meeting a series of follow-up questions were asked to support explanations provided at the meetings and to respond to specific points raised.

The site visits were undertaken between 22 January 2013 and 4 March 2013. As the programme of site visits progressed, additional matters that had the potential to affect the robustness, comparability and transparency of data were identified and it was necessary to revert to some of the companies previously visited to gather further information.

3.4.5 Stage 3: Evaluation of information and quantification of the impact on ACTS

The information obtained from the preliminary analysis and site visits was analysed to identify areas where reported data was not robust, comparable and transparent.

Where the matter identified had a significant impact on the costs allocated to the retail business unit and to household customers the impact on CTS and ACTS was calculated.

As described in section 3.2 Ofwat provided us with a simplified version of the ACTS model with which to perform our calculations.

3.4.6 Stage 4: Recommendations

Categories of recommendation

Where the review identified areas where the accounting separation data reported in the Retail Table was not robust, comparable and transparent, we have identified possible recommendations to address these matters. These recommendations are intended to achieve Ofwat's objective of improving the robustness, comparability and transparency of future reported accounting separation data.

We have identified three categories of possible recommendation. Each of the three categories is broadly aligned to the concerns that this targeted review is seeking to address. However, it is important to note that many of the recommendations will have a positive impact across all of the areas, e.g., a recommendation to improve the robustness of data is also likely to improve its comparability.

The three categories of recommendation relate to:

- **Assurance:** Statements of opinion being given over the basis of preparation and/or the accuracy of reported data. This category of recommendation is generally applicable to matters concerning the **robustness** of data.

- **Guidance:** Changes to regulatory guidance to clarify the basis on which data is recognised and recorded in companies' reported data. This category of recommendation is generally applicable to matters concerning the **comparability** of reported data. In proposing a recommendation we have reviewed Ofwat's existing guidance. Where we consider existing guidance to be clear but is not being followed we recommend that this is addressed by Ofwat directly with the relevant company. Where we consider existing guidance is not clear, or there is no guidance we recommend that this is addressed with the sector as a whole.

- **Disclosure:** Publication of additional information to allow the user of the data to understand the basis on which it has been prepared and providing greater insight into differences between companies' retail costs that arise from the way in which their retail operations are organised. This category of recommendation is generally applicable to matters concerning the **transparency** of reported data but is also relevant to comparability.

Before we report on the targeted review findings we think that it is useful to discuss at a high level the categories of possible recommendation, their benefits and drawbacks and the situations where we consider they might be applicable. This discussion is set out in appendix F.

We note that the benefits and drawbacks of the recommendations will often differ depending on whether they are viewed from the perspective of the companies or from the perspective of users of the data (including Ofwat). In general greater assurance, more prescriptive guidance and greater disclosure is beneficial to the user of the information (subject to the law of diminishing returns) but imposes a greater burden on the preparer (generally in time and cost).

Having set out a proposed recommendation to an issue identified we then consider whether its application indicates that an adjustment should be made to data that has been previously reported by the companies. Such adjustment could take the form of:

- Provision of **further information**, with either additional data being reported (including non-financial information), or the disaggregation of reported data between specified components.

- **Restatement** of reported data on alternative bases.

Where we have identified minor findings in respect of the specific approach of each company, we have set out such findings in appendix Z. We recommend that these findings are communicated to each company in a letter from Ofwat ('company specific letter').

Our approach to proposing recommendations

In determining which is the most appropriate recommendation to apply in relation to a particular issue we have had regard to a number of factors, including:

- The **magnitude** of the impact of the issue. The recommendation must be a proportionate response to the potential scale of the problem. In considering scale we have considered both whether the matter to which it relates is immaterial or whether the difference that any proposed recommendation is likely to make is immaterial (i.e., there is a negligible impact on CTS).

- Whether it is **achievable** or ought to be achievable given, for example, the systems used by each company.
- The **acceptability** of the proposal both to those having to report the information and those having to review it, including Ofwat, for example would the proposal require commercially sensitive information to be reported.
- **Costs** that would potentially be incurred in implementing the recommendation, both monetary and in employee and management time.

For certain of the issues that we have identified we set out more than one proposed recommendation. Where this is the case we rank these in the order we consider to be most appropriate and explain why we have proposed the alternatives.

Although we set out a proposed recommendation for each issue that has been identified by the targeted review it is important that recommendations are considered together and measured against the above criteria. This will determine whether there are proposed recommendations that address more than one identified issue and therefore may be preferable to a series of recommendations.

For this reason we set out in section 8 an overview of all of our proposed recommendations grouped under the headings of assurance, guidance and disclosure along with any suggested actions to be taken in regard to previously reported data.

3.5 Classification of findings

Having described the approach that we have undertaken in performing the review we provide a brief summary as to how we have sought to classify our findings.

In section 3.3 we noted that we sought to understand whether the data reported in the Retail Table in 2011/12 was **robust**, **comparable** and **transparent** and we defined those terms. Accordingly we set out our findings under these headings.

The purpose of the review was to identify factors that affected whether the data reported in the Retail Table was robust and, if it was, how stakeholder's perception of the data could be improved. Our findings in relation to robustness, comparability and transparency are set out in sections five, six and seven respectively.

However, in considering the extent to which companies' retail business units are comparable we have identified a series of factors that affect the comparability of data.

These factors, many of which are interrelated, mean that in the event all cost allocations and accounting policies were applied in a perfectly consistent way, differences would remain in components of the reported data. We describe these factors in section 4 setting out the nature of the likely impact on of these factors on the comparability of total retail costs between companies.

3.6 Parallels with other industries

In performing the review we have considered the practices followed and experiences of other industries where accounting separation has been introduced and where accounting separation data is reported. Although not directly analogous to the water sector, current practices and lessons learned in these other industries provide insights to:

- Identify issues experienced and how they were addressed.
- Inform and justify proposed recommendations arising from the review.

The industries we identified as being most relevant and where we have been able to identify information to draw parallels are:

- ► Electricity where Public Electricity Suppliers (PESs) were required to separate their distribution and retail businesses over a ten year period from 1990 to 2000.
- ► Telecommunications where certain market participants are required to produce accounting separation information.
- ► Postal services where Royal Mail is required to produce accounting separation information.

3.6.1 Electricity

For the PES separation, information published by Ofgem (and its predecessor Offer) provides some analysis of accounting and cost allocation issues that were encountered and how they were tackled. It is important to note that the separation took place gradually and that as well as accounting separation there was a physical separation of the distribution and retail (supply) businesses. One key difference between the PES separation and water is that the retail costs that were considered by Offer included the cost of electricity purchased from wholesalers and the use of system charges for transmission and distribution. Consequently the costs of retail operations (billing and call centres) accounted for a relatively small proportion of total retail costs and they were less of a focus than wholesale and distribution charges.

Relevant issues that were experienced and which have parallels in this review are:

- ► General and support costs: Because of the legal separation of retail and distribution businesses the use of shared services was discouraged. Notwithstanding this, an accounting guideline introduced before privatisation contained specific allocation rules that corporate overheads be allocated on the basis of salaries (50%) and net assets measured on a CCA basis (50%).[3]
- ► Fixed assets: Differences were found in accounting treatments as some PESs owned assets required to deliver services (IT systems, vehicles and certain property) whereas others leased them from third parties or associated companies. Adjustments were proposed to standardise accounting treatments.

In 1999 Ofgem commissioned a review into operating cost for PESs, which included customer services costs. The review considered the appropriateness of cost allocation made in accordance with CSC 194 and proposed a number of changes such that costs were allocated on a 'usage' basis.[4] The impact of the review was to reallocate around £300 million of operating costs from distribution to supply (an uplift of 40 – 50% of retail operational costs). The key areas of reallocation were:

- ► Customer services costs which had previously been recorded in distribution were moved to retail on the basis the distribution business did not need to know the customer name (CSC 194 had required these costs to be allocated between distribution and retail).
- ► Metering reading and data processing costs were moved to retail from distribution.
- ► Corporate overheads were reallocated using a measure based on turnover, historic cost operating profit, employee numbers and historic cost net assets (each variable being given equal weight). Using this measure around one-third of corporate overheads were allocated to retail (previously around 10% had been allocated using CSC 194 guidelines).

It is important to recognise that the changes resulting from Ofgem's review were not as a result of companies misallocating or misreporting costs but the provisions of CSC 194 not

[3] Accounting guideline CSC 194.
[4] The results of the review are set out in Ofgem's Distribution Price Control; Review Draft Proposals dated August 1999.

reflecting the changed business structure. Within section 6 we consider the comparability of reported accounting separation data and, where relevant refer to the PES separation.

3.6.2 Telecommunications and postal services

With regard to Telecommunications and Royal Mail, Ofcom requires the annual preparation of accounting separation information. The accounting separation information that is reported to Ofcom is in relation to services provided by the market participants. For example, BT Group plc reports costs, revenues, assets and liabilities into specified Markets, Technical Areas and Disaggregated Activities where they are deemed to have Significant Market Power.

The principal parallels that we refer to in this report are in relation to the assurance that is given over published regulatory accounts in these sectors. Within section 5 we describe the arrangements in place between the company, the regulator and the auditors, the scope of the auditors' procedures and the opinion given. We have used practices in these sectors to information our recommendations relating to assurance.

3.6.3 Retail costs

Based on 2011/12 reported accounting separation data the CTS reported by the water companies ranges from £13.81 to £51.35 per unique customer. Discounting the two lowest and two highest companies the range is narrowed to £16.16 to £39.41 per unique customer.

The PESs reported supply business costs per domestic customer in 2000/01 (1998/99 prices) in a range of £29.32 to £45.04. Discounting the two highest and two lowest gives a range of £31.00 to £35.80.

It is evident from this comparison that the spread of costs in water is much greater but the costs in water are generally lower. We understand the activities making up the electricity costs to be broadly comparable with the activities making up the costs incurred by the water companies but note that the information reported in respect of the PESs is not sufficiently granular to undertake a more detailed comparison.

We note that the findings of the review indicate that the wider spread in costs in the water sector is not attributable to inconsistencies with the recording and reporting of cost information and consequently is more likely to be as a result of the factors outlined in section 4.

4. Factors influencing comparability

4.1 Introduction

The scope of the targeted review includes an examination of the appropriateness of individual companies' cost allocations and accounting policies, together with the consistency of these between companies and the potential impact of observed inconsistencies on ACTS.

In developing our approach to the review and reporting the findings, our view was that it was important to recognise that a range of factors are capable of influencing the observable differences within the reported data. In particular, it is likely that factors exist that mean that even in the event that all cost allocations and accounting policies were applied in a perfectly consistent way, there would still be significant differences in components of the reported data.

In this section, we describe the factors that influence the comparability of data between companies that do not result from the way transactions are recorded and reported. Where possible, we describe the nature of the likely impact on total retail costs. We describe each of the factors separately below. However, it should also be recognised that there may also be an element of interaction between them.

4.2 Factors which affect comparability that are not influenced by the way in which costs are recorded and reported

The factors identified are as follows:

- **WaSC or WOC:** WaSCs provide both clean water and sewerage services to customers whereas WOCs provide only clean water. The nature of retail service provision is such that there are likely to be economies of scope on some elements meaning that provision of two services is less than twice as costly as the provision of one. However, it is possible for a company to mitigate the impact of this by making changes to the retail business unit structure.

- **Size of bill:** The relative size of a typical household bill varies between companies. Other things being equal, there is likely to be a positive correlation between the size of bill and the quantum of customer debt.

- **Meter penetration:** The current penetration of metering varies significantly between companies. Companies with higher penetrations of metering will incur proportionately larger meter reading costs and may also incur higher costs in respect of billing and non network customer enquiries and complaints. We understand that Ofwat's proposed ACTS model makes allowances for differential metering costs.

- **Company size:** There is a wide range of sizes represented amongst the 21 companies (now 18 companies following mergers) and simple logic suggests that there are likely to be some influences on retail costs from economies of scale. Again, it could be possible to mitigate the impact of this by making changes to the retail business unit structure.

- **Billing arrangements:** Companies follow different approaches in respect of billing and debt collection, with a number using services provided either by other companies or by local authorities which has the potential to impact retail costs, in particular where the risk of bad debt is passed to a third party.

- **Demographics:** Differences in regional and demographic circumstances exist, for example differences in average wages and the local economic circumstances. These differences are likely to affect retail costs.

- **Efficiency:** There are inevitably differences in the levels of efficiency achieved between companies which impact on the unit cost of service provision that they are able to achieve.

We understand that Ofwat is separately looking at factors that drive bad debt costs. Although these factors are likely to impact on the costs incurred, they should not impact on the way in which costs are recorded, reported and allocated, nor the associated accounting policies.

In addition to the above factors the retail business unit structure was identified as being capable of influencing the way in which the costs are recorded and reported. We consider this factor further below.

4.3 Retail business unit structure

The underlying business structure adopted by the water companies does impact comparability. During the review, it was apparent that the underlying retail business unit structure adopted by the water companies to deal with core customer services activity falls into one of the following categories:

- Outsourced to a third party
- Outsourced to separate group company
- Managed internally but recorded and managed as a separate directorate

The differences in underlying business structure make comparability of accounting separation data difficult due to the treatment of overhead costs.

Where a third party or separate group company provides core customer services to the water company, the company providing the service will incur its own overhead costs. The overhead cost is then included as part of the overall charge invoiced back to the water company and therefore is included as a direct cost (rows 1,2,3,7 and 8) within the Retail Table. By contrast, where core customer services are undertaken by the water company itself, overheads are a shared cost across the business and are therefore reported as part of general and support expenditure (row 18).

On this basis, comparison of the level of direct costs and general and support expenditure allocated to the Retail Table across water companies will be misleading as direct costs may or may not include an element of overheads, depending on underlying business structure.

There is no overall impact on ACTS as these costs are included within the Retail Table. However there will be an impact on any calculation which disaggregates ACTS between direct costs and general and support expenditure. This is discussed further in section 6.

It is important to note that these factors do not affect the robustness of reported data or whether there are differences arising from similar transactions being recorded and reported inconsistently.

4.4 Recommendations

To facilitate comparability the Methodology Statement should set out:

- The underlying business structure adopted by the company.
- Details of any outsourced functions including agreements with other water companies and local authorities. The percentage of income outsourced for billing and collection should be included, identifying where the risk of collection is transferred to a third party.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

5. Findings in relation to robustness

5.1 Introduction

In this section of the report we consider the robustness of financial data included within the Retail Table.

In the context of the review we have defined robustness to mean the extent to which the process of preparation and approval results in reported data which accurately reflects the costs incurred in performing the activities set out in the Retail Table.

In this section we set out an overview of:

- How financial transactions are recorded and monitored (section 5.2)
- The process undertaken to prepare and internally approve the Retail Table (section 5.3).
- External review performed on the Retail Table (section 5.4).
- Summary of findings and proposed recommendations (section 5.5)

The Retail Table contains financial data both in respect of operating expenditure and capital expenditure. The review has found that the processes undertaken by companies to prepare financial data in respect of operating expenditure and capital expenditure are often different. Accordingly, we consider operating expenditure and capital expenditure separately in this section.

The process set out in sections 5.2 to 5.4 is broadly reflective of the process undertaken by all companies in the preparation of the Retail Table. However to the extent that there are differences in the process that have an impact on the robustness of data, these are separately identified.

5.2 How financial transactions are recorded and monitored

5.2.1 How financial data is recorded

Operating expenditure

Transactions are coded to the general ledger system by cost centre and expenditure type throughout the financial year as part of business as usual financial processes. We consider that it is reasonable to assume that these processes are generally robust.

Capital expenditure

Transactions are coded to the general ledger system by project code. The transactions are recorded using a historic cost accounting approach (i.e., the original cost of acquiring or constructing the asset) however fixed assets are reported in accounting separation data using a current cost accounting (CCA) approach. Under a CCA approach, an asset is valued on the basis of how much it would cost to replace the asset with another that would provide the same service capability allowing for any difference both in the quality of output and in operating costs (RAG1 para 1.7.3). ‘Current Cost Depreciation’ (as included within row 28 of the Retail Table) is therefore stated using a CCA approach (also referred to as CCD).

Although capital expenditure is coded to a project code within the general ledger on a historic cost basis, a separate CCA fixed asset register is often maintained separately and sometimes outside the general ledger system, typically in a spreadsheet. Unless there is a reconciliation process any information subsequently reported in the Retail Table is likely to be less robust than if CCA fixed asset register was maintained within the general ledger system.

5.2.2 How financial data is monitored

Operating expenditure

Each cost centre is owned by a budget holder and is reviewed on a monthly basis by the budget holder as part of the management accounts process. The management accounts are also subject to review by directors at a summary level. Any information subsequently reported in the Retail Table that is derived directly from the general ledger is likely to be robust as a result of the regular review process.

Capital expenditure

CCD is calculated annually and is therefore not monitored through the year. On this basis the CCD charge may be less robust than data which is monitored regularly.

5.3 The process undertaken to prepare and internally approve the Retail Table

The robustness of data included within the Retail Table is dependent on the process of preparation and approval. An overview of the process which is set out below falls broadly into the following three stages:

- **Stage 1:** Data extraction from the general ledger system to spreadsheets.
- **Stage 2:** Manual data analysis and presentation within the Retail Table.
- **Stage 3:** Internal review and approval of the Retail Table.

5.3.1 Stage 1: Data extraction from the general ledger system to spreadsheets

Operating expenditure

Financial data is extracted from the general ledger system directly into a spreadsheet and arranged by cost centre and expenditure type. Typically cost centres are aggregated into either business units, as defined in Ofwat's accounting separation guidance, or as support cost centres.

The review highlighted that costs relating to core customer services and doubtful debts were typically extracted directly from the general ledger system and reported in the Retail Table without significant adjustment.

Core customer services such as billing, debt management, non network call centres and meter reading are managed as a separate department or directorate. The costs of these activities are included in the following rows within the Retail Table:

- **Row 1:** Billing
- **Row 2:** Payment handling, remittance and cash handling
- **Row 3:** Debt management
- **Row 7:** Non network customer enquiries and complaints
- **Row 8:** Meter reading

Transactions relating to these activities are typically coded at source to cost centres as part of the normal day to day accounting and reporting process. As such, the costs are not subject to manual intervention in preparing the Retail Table and, as a consequence, the data is considered to be robust. The costs of these activities represent between 22% and 52% of individual companies' CTS and, as set out in appendix G, 31.2% of ACTS as a whole. The CTS and ACTS attributable to rows 1,2,3,7 and 8 are set out in appendix H.

The cost of doubtful debt included within row 4 of the Retail Table is the cost included within the regulatory accounts. As such, the costs are not subject to manual intervention in preparing the Retail Table and, as a consequence, the data is considered robust. As set out in appendix G, doubtful debt represents between 5% and 49% of individual companies' CTS and 36.1% of ACTS as a whole.

Capital expenditure

As set out in section 5.2.1 the current cost fixed asset register is not always maintained within the general ledger system.

5.3.2 Stage 2: Manual data analysis and presentation within the Retail Table

Operating Expenditure

Cost centres are aggregated into Business Units. A number of cost centres include costs which are treated by the company throughout the year as wholesale activities but which, per Ofwat's guidance, are defined as a retail activity and therefore are recorded within the Retail Table. Accordingly, either the total or part of the value of such cost centres is required to be identified and moved across into the Retail Table within the spreadsheets used by each company. An example of such costs is the cost of investigating network customer enquiries.

Next, shared costs that have been recorded within support cost centres (e.g., HR, Finance, Support etc.) are allocated between retail and wholesale business units. Support cost centres include costs such as general and support expenditure, scientific services and local authority rates. Typically, each cost centre is reviewed and expenditure that is known to relate to retail activities is allocated in full to the Retail Table. An example is the cost of a support licence for the retail billing system. This cost would typically be included within the IT support cost centre but it is indentified and allocated in full to the Retail Table. The balance of each cost centre is then allocated between the retail and wholesale business units based on a cost driver.

Finally, once total retail costs have been identified, the costs of each retail activity are split between household and non-household customers using a cost driver. The cost drivers used vary depending on the activity being split and examples include the number of household and non-household customers and number of bills.

The process set out above to reallocate cost centres across the retail-wholesale boundary, to allocate support cost centres to retail and to allocate retail costs between household and non-household customers is a manual process that is performed on an annual basis using information that is not maintained within the general ledger. For example cost driver information is typically provided by other parts of the business. Furthermore the calculations required to allocate costs are performed in a separate spreadsheet or separate tab of the spreadsheet. Where such manual intervention is required to prepare the Retail Table the resulting reported information may be (or may be perceived to be) less robust than if the data was extracted from the general ledger and monitored through the monthly management accounts process.

Capital Expenditure

Fixed assets within the CCA fixed asset register are typically classified as retail assets, wholesale assets or management and general (M&G) assets. Examples of M&G assets include the head office building and the finance system. Retail and wholesale assets are fully allocated to the retail and wholesale business units respectively. M&G assets are allocated across the retail-wholesale boundary using a number of different drivers. The most frequently used drivers are FTEs and total direct costs.

There are a number of concerns identified in respect of the process set out above. During the review, it was apparent that some companies are unable to easily identify CCD amounts for assets allocated in full or in part to the Retail Table. One of the reasons provided was that companies were not able to specifically identify individual assets within their underlying accounting records as when the requirement to state assets under a CCA approach was first introduced, the calculation was not undertaken on an asset-by-asset basis, but rather by class of asset (such as land, buildings, fixtures and fittings). Subsequently additions have been either been recorded within the CCA fixed asset register on an asset-by-asset basis or by class of asset.

Furthermore the CCA fixed asset register is typically maintained by a team or individual who is not part the team responsible for the preparation of the Retail Table. On this basis they do not necessarily have detailed knowledge of the wider accounting separation context and how the CCA fixed asset data is relevant to it.

5.3.3 Stage 3: Internal review and approval of the Retail Table

The process undertaken to prepare the Retail Table involves manual calculations and spreadsheets. In order to review the Retail Table it is apparent that each company relies on analytical review and comparison to prior years and expectations performed by Finance or Regulation staff.

It appears that there is relatively limited detailed review of individual calculations performed by someone who is independent to the process or preparation, even on a sample basis. Furthermore, although the majority of costs reported in the Retail Table relate to activities undertaken by core customer services, the Customer Service Director, or similar, is not always involved in the review and approval process.

In all cases the Retail Table is subject to approval by the Regulatory Director or Finance Director prior to publication however documentation of the approval is not always retained.

5.4 External review performed on the Retail Table

The robustness and perception of robustness of financial data included within the Retail Table is dependent on the external review to which the Retail Table has been subject. Whilst there was some requirement for external review under the June return audit procedures, in 2011/12 there was no requirement for companies to engage a third party to review and/or approve the Retail Table.

The external assurance identified during the review is set out below:

- **Reporter:** Historically, a ‘Reporter’ was engaged by each company to undertake a review of data reported in the June Return. We have identified that a number of companies have engaged a Reporter to undertake a level of independent checks of the Retail Table (as part of independent checks on other data submitted to Ofwat). For example, in some cases the Reporter was asked to reconcile information to source data (for example the number of customers) and compare the financial data within the Retail Table to prior years.

- **External audit:** Some companies have published the Retail Table as part of their regulatory accounts. As the regulatory accounts are audited it appears therefore that the accounting separation data has been subject to some form of external audit however the level of materiality applied in relation to the Retail Table is unclear. We note that the Retail Table will be included within the regulatory accounts and subject to the corresponding audit from 2012/13.

5.5 Summary of findings and proposed recommendations

5.5.1 Findings

The robustness of data included within the Retail Table can be summarised by the extent to which costs are extracted from data contained within the general ledger:

- Direct costs that relate to core customer services activities are generally extracted directly from companies’ accounting systems and reported in the accounting separation tables with little or no manual intervention. In addition the doubtful debt expense is reconciled to the figure reported in the statutory accounts. As such we consider that the operating costs associated with these core customer services activities are robust. These costs account for over 60% of total retail costs.

- Costs relating to activities included in retail business unit that are not part of the core customer service activities (e.g., network customer enquiries and complaints) often have to be disaggregated from wholesale activities to be included in the Retail Table. In addition general and support expenditure is not allocated to retail business unit activities as a matter of course and therefore requires a manual allocation process to be undertaken. Where manual intervention is required to prepare the Retail Table the resulting reported information may be (or be perceived to be) less robust.
- CCD is not always maintained in the general ledger system but is recorded within a separate CCA fixed asset register. The regularity of which this data is monitored is unclear. As the depreciation cost reported in the Retail Table is extracted from the CCA fixed asset register and not the general ledger this amount may be less robust.

5.5.2 Recommendations

In proposing recommendations in relation to robustness we have applied the principles set out in appendix F irrespective as to whether the data itself is robust and comparable. We consider that obtaining both internal and external assurance is important in addressing stakeholder's perceptions regarding the quality of the data reported in the Retail Table. Our recommendations in this regard relate both to internal and external assurance.

Internal assurance

Under paragraph 5 of condition F of the licence, each company is obligated to prepare segmental accounting information. However, this obligation has been superseded by RAG 4.04 (published in February 2013) which covers guidelines for accounting separation data.

In March 2012 Ofwat issued the document 'Risk and compliance statement – guidance'. The document sets out Ofwat's expectations for the risk and compliance statement. The document states that *'The purpose of the risk and compliance statement is for the company to confirm that it has complied with all its relevant statutory licence and regulatory obligations that have not been confirmed by other processes...'* The guidance sets out a series of expectations including that the company has '*satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations*'.

Information Notice (IN) 12/07 states that *'from 2011-12 onwards each company should submit a risk and compliance statement.'*

Also relevant is IN 13/01 which provides that from 2012/13 the accounting separation tables are to be included within the regulatory accounts. Within the regulatory accounts the directors are required to state that they have fulfilled their obligation to prepare accounting statements that comply with the requirements of Condition F and with Regulatory Accounting Guidelines. Accordingly the inclusion of the accounting separation tables in the regulatory accounts brings them within the scope of the directors' responsibilities with regard to the regulatory accounts.

Thus from 2012/13 internal assurance over the accounting separation tables will be provided through the directors statement in the regulatory accounts. This internal assurance is supported by the sign off given by the directors in the risk and compliance statement.

We note that in the context of the business as a whole the values contained in the Retail Table are likely to be significantly smaller than the wholesale business units. In order to address the potential issue that limited consideration is given to the Retail Table our recommendation is that each company specific letter (to be issued following this review) draws attention to the fact that Ofwat considers the Retail Table to be important, as the information is to be used in the assessment of future prices, and reminds companies of their obligations in respect of the regulatory accounts and the risk and compliance statement.

For Ofwat's information we describe below examples of the internal controls and review procedures we might expect to see, although we note that it would be for the companies themselves to determine what steps were required. We would not propose, at this stage, to include these in the company specific letters:

- ► A map of the detailed process undertaken to extract and analyse data into the Retail Table on a step by step basis should be maintained.
- ► Controls over spreadsheet data should be implemented such as a reconciliation between total cost per the extract and total cost per the general ledger.
- ► An independent check of allocation calculations should be undertaken and documentation retained. These checks could be done on a rotational sample basis.
- ► Retail and M&G assets should be separately identifiable within the CCA fixed asset register.
- ► Formal analytical review procedures should be undertaken, the extent of which is predetermined and documented. The checks should be undertaken by individuals separated from preparation process. The checks should include comparison to prior years, expectations and budgets.

External assurance

IN13/01 states that the accounting separation tables are to be included within the regulatory accounts from 2012/13 and subject to an audit opinion. This audit opinion should improve the perception of the robustness of data. However, external auditors are likely to set materiality in the context of the business as a whole (i.e., wholesale plus retail) and, therefore specific audit procedures undertaken in respect of the Retail Table may be limited. In order to provide further confidence in the robustness of the retail data, further assurance could be obtained via agreed upon procedures:

In determining what additional assurance might be appropriate we have considered practices in other sectors.

- ► In the telecoms sector, accounting separation data is included within the regulatory accounts and is therefore required to be subject to audit. The auditor is typically the statutory auditor however in some jurisdictions (including the UK) the audit of the regulatory accounts is governed by a 'tripartite' arrangement between the regulator, company and auditor. Under this arrangement the auditor is engaged jointly by Ofcom and the company which means the scope of the audit is jointly agreed each year and the auditors have a duty of care which extends to the regulator as well as the company. The arrangement includes the level of assurance that the auditor is required to give over the regulatory accounts.
- ► In the electricity sector, accounting separation data is included within the regulatory accounts. The auditor is required to prepare an opinion on the regulatory accounts as a whole and not specifically on accounting separation data. However there is a requirement within the licence conditions for certain information to be subject to audit through agreed upon procedures (for example in relation to information to be submitted to the regulator in respect of periodic price Control Revenue Information). The licence conditions do not set out specific agreed upon procedures however the procedures are included in a tripartite agreement between the company, the auditor and the regulator for each agreed upon procedures engagement.
- ► In the postal sector, the regulator requires accounting separation to be implemented through the preparation of separate financial statements for each of the disaggregated functions. The auditor is then required to provide an opinion on each of the financial statements and to achieve this, materiality is set for each of the disaggregated functions. The arrangement that governs the scope and opinion of the regulatory audit is a bipartite

agreement between the company and the auditor, however a duty of care from the auditor to the regulator is acknowledged in respect of the audit work, audit report and audit opinion.

We recommend that the Retail Table and ST6 should be subject to agreed upon procedures to be performed by an external auditor. This requirement should be set out in an information notice to cover the 2013/14 accounting separation data (to be issued in January 2014).[5] The agreed upon procedures which are set out below should be subject to a bipartite agreement the company and the external auditor:[6]

- Obtain and read the Methodology Statement prepared by the water company to confirm it is in accordance with current guidance. Report exceptions.
- Walk through the process used to prepare the tables to determine it is in accordance the Methodology Statement. Report exceptions.
- Agree total operating expenditure per the Retail Table and total operating expenditure per the Wholesale Table(s) to total operating expenditure per the Regulated Accounts.
- Compare current year and prior year figures in the Retail Table, obtain explanations for significant movements (for example movements in excess of 10%).
- Agree Core Customer Services costs to the general ledger.
- Agree Doubtful Debts to the general ledger.
- For direct costs originally recorded as wholesale activities that have been reclassified to retail, understand the basis of reclassification and agree back to source data.
- Reperform all G&S cost allocation calculations using cost drivers set out in the Methodology Statement. For a sample of G&S expenditure agree the total cost to the general ledger and the cost data to source data.
- Reperform scientific services cost allocation calculations using cost drivers set out in the Methodology Statement.
- Reperform other business activities cost allocation calculations using cost drivers set out in the Methodology Statement. Agree total CCD per Retail Table to total CCD per ST6. Agree total CCD per ST6 to current cost fixed asset register.
- For a sample of M&G assets, understand the basis of allocation between retail and wholesale and agree back to source data and provide description of source data.
- For each row within the Retail Table, understand the basis of allocation between household and non-household and reperform the calculation using the cost drivers set out in the Methodology Statement. Agree the cost driver figure used in the calculation to source data.

The nature of the Retail Table is such that it would not be appropriate to request companies obtain a separate ‘fairly present’ or ‘true and fair’ audit opinion. Reasons for this include the fact that the base data used to create the Retail Table is already subject to audit as part of the regulatory accounts and that currently there is no legal separation of retail businesses.

[5] We understand that it is not feasible to require this in relation to 2012/13.
[6] We have proposed a bipartite arrangement as this is consistent with June Return arrangements. We note that most other sectors have tripartite arrangements in place. In the event a bipartite agreement is put in place consideration should be given to a duty of care being acknowledged to Ofwat.

6. Findings in relation to comparability

6.1 Introduction

In this section, we consider individual companies' cost allocations and accounting policies, together with the consistency of these between companies and the potential impact of observed inconsistencies on the ACTS based on the 2011/12 reported accounting separation data.

For the purposes of the review we considered **consistency** in the context of whether similar transactions are recognised and reported in the same way across companies. At section 6.2 below, we set out three key categories of inconsistency identified by the review.

To consider consistency and report findings in this context, we disaggregate ACTS and the CTS for each company by retail activity or groups of retail activities for detailed comparison and analysis. The disaggregated data is presented at appendix G. The detailed comparison and analysis is set out in section 6.3 by retail activity or groups of retail activity and for each, the following is discussed:

- The activities, assets and underlying costs included in the Retail Table.
- Cost drivers used to allocate costs between wholesale and retail activities.
- Cost drivers used to allocate within the Retail Table to household and non-household activities.
- Impact of inconsistencies upon CTS and ACTS.
- Recommendations.

For doubtful debt, we consider the impact of inconsistencies in bad debt and turnover recognition policies upon CTS and ACTS.

Finally, at section 6.4 we consider the overall impact of inconsistencies identified on ACTS.

6.2 Categories of inconsistency

During the review, three key categories of inconsistency were identified as follows:

- Interpretational differences.
- Differences in accounting treatment and billing policy.
- The treatment of shared costs.

Each area of inconsistency is discussed in detail below. Where applicable, the impact on CTS and ACTS is quantified and related recommendations are set out in section 6.3.

6.2.1 Interpretational differences

During the review it was apparent that companies have different interpretations as to whether certain activities should be classed as retail or wholesale and also whether the costs of certain activities should be treated as direct costs or general and support expenditure.

Whether costs should be treated as wholesale or retail

During the review it was apparent that a key source of inconsistency is the interpretation of the definition of the 'network customer enquiries and complaints' activity (row 10).

The difference in interpretation has resulted in a lack of comparability in the data reported for 2011/12.

The treatment of network calls is discussed in more detail at paragraph 6.3.4 below.

Whether costs should be treated as direct costs or general and support expenditure

There is a difference of interpretation around whether certain costs should be treated as direct costs or as general and support expenditure. However as the cost is still treated as a retail cost and included in the Retail Table, total CTS and ACTS are not affected overall.

The difference in interpretation has resulted in a lack of comparability in the data reported for 2011/12.

Differences relating to whether costs should be treated as direct costs or G&S expenditure are discussed in more detail at section 6.3.9, below.

6.2.2 Differences in accounting treatment and billing policy

During the review, a number of different accounting treatments and billing policies were identified that might cause accounting separation data reported and, consequently CTS, to be inconsistent between companies. The differences identified are discussed at a summary level below and considered in more detail, together with the impact on CTS and ACTS at section 6.3.2.

Billing in the name of 'The Occupier'

Ten companies issue bills in the name of The Occupier where water usage is identified, typically through a meter, but the occupier of the premises is unknown. NWT also issue bills in the name of The Occupier to unmetered properties. The effect of billing in the name of The Occupier does impact CTS and ACTS as where this happens any revenue that is billed and which is not collected will be provided for as doubtful debt. Consequently, a company that bills in the name of The Occupier is likely to have a higher doubtful debt charge compared to a company that does not.

Billing in the name of The Occupier is discussed in more detail at section 6.3.2.

Write off or write back of revenue for void properties

During the review, one of the water companies identified two different ways in which the industry accounted for revenue where one customer had been replaced by another at a particular property leaving a debt and the leaving date and whereabouts of the original customer was unknown.

The two different treatments have an impact on CTS and ACTS as companies either deem that the previous customer left the day before the new customer moved in, in which case all uncollected revenue is treated as a doubtful debt or deem the customer left at some earlier point in which case a proportion of the uncollected revenue is cancelled and not treated as a doubtful debt. Doubtful debt costs will be lower when the latter treatment is followed.

Write off or write back of revenue for void properties is discussed in more detail at section 6.3.2.

Revenue with a low probability of collection

During the review, a concern was identified that the adoption of FRS 5 might impact the level of doubtful debt recognised in the Retail Table and, therefore, in the CTS per company and the ACTS as a whole.

FRS 5 allows companies to net off the relevant proportion of the bad debt provision against revenue for debt where there is a low potential for recovery. This treatment however is not permitted within the regulatory accounts where revenue and doubtful debt must be stated gross resulting in the requirement for a reconciliation between the statutory accounts and the regulatory accounts to be published.

Given that doubtful debt is required to be stated gross of any FRS 5 adjustment in the regulatory accounts (regardless of how reported in the statutory accounts) and that the doubtful debt figure per the regulatory accounts is that used to calculate CTS and ACTS, the FRS 5 adjustment should not impact CTS, ACTS or the comparability of accounting separation data providing all companies have complied with regulatory accounting guidelines. During the review we saw no evidence that revenue not recognised in the statutory accounts in accordance with FRS 5 was not grossed up in the regulatory accounts.

Billing policy for revenue with a low probability of collection

During the review, a concern was identified that companies might have adopted a policy of ceasing to invoice customers for usage where those customers had a history of non payment of debt.

To determine whether this policy was adopted in practice, each company was asked during the review whether they had adopted this policy during 2011/12. None of the companies stated that they had adopted this policy and on this basis, there is no impact on CTS or ACTS.

6.2.3 The treatment of shared costs

G&S expenditure and the treatment of shared costs are a source of incomparability across the sector.

Whilst it is easy to determine the proportion of total G&S expenditure that has been allocated to the Retail Table by company, undertaking this simple calculation to perform a comparison does not take account of:

- How each company is structured, as this will impact upon not only the level of overhead costs incurred but also on whether these costs are reported as direct costs or as G&S expenditure.
- Different interpretations as to what should be treated as G&S expenditure.

In addition although Ofwat has issued guidance, each company has a degree of discretion over the methodology it chooses to allocate costs, including the selection of appropriate cost drivers.

The combined effect of the above means that comparability of G&S expenditure across the sector is difficult without much greater disclosure and the performance of extensive detailed analysis. The treatment of shared costs is discussed further at section 6.3.9 below.

6.3 Comparison and analysis of data reported in the 2011/12 Retail Table

To consider consistency and report findings in the context of consistency, we have disaggregated ACTS and the CTS for each company by retail activity or groups of retail activities and this analysis is set out at appendix G. By disaggregating ACTS and CTS, it is possible to identify and understand variances at a more detailed level and also determine how significant activities and inconsistencies affect ACTS and CTS.

Costs relating to rows 9, 11, 13 and 14 are referred to in this section however they are excluded from Ofwat's ACTS model on the basis that they are either non-household costs (rows 13 and 14) or may be treated as wholesale costs from 2012/13 based on our understanding of Ofwat's preferred definition of retail (rows 9 and 11) as set out in its price review methodology consultation. The costs can be seen in the analysis set out at appendix Y.

A summary of ACTS for 2011/12 by retail activity or groups of retail activities is set out below:

Row line	Description	ACTS (£)	%	Paragraph number
1,2,3,7,8	Core customer services	9.14	31.20%	6.3.1
4	Doubtful debts	10.59	36.10%	6.3.2
5	Charitable trust donations	0.45	1.50%	6.3.3
10	Network customer enquiries and complaints	1.12	3.80%	6.3.4
15	Customer-side leaks	0.67	2.30%	6.3.6
16	Other direct costs	0.27	0.90%	6.3.7
6, 12	Other costs included within direct costs	0.40	1.40%	6.3.8
18	General and support expenditure	3.12	10.60%	6.3.9
19	Scientific services	0.14	0.50%	6.3.10
20	Other business activities	0.16	0.60%	6.3.11
22	Local Authority rates	0.17	0.60%	6.3.12
23	Exceptional items	(0.06)	(0.20)%	6.3.13
25	Third party services	0.01	0.00%	N/A
28a, 30	Adjusted CC depreciation excl metering, Amortisation of intangible assets	3.16	10.80%	6.3.14
29	Amortisation of deferred credits	(0.03)	(0.10)%	N/A
32a	**Total**	**29.31**	**100.00%**	

6.3.1 Core customer services activities

The activities and related costs included in the Retail Table

As set out in section 5.3.1, core customer services such as billing, debt management, non network call centres and meter reading are managed as a separate department or directorate.

The costs of core customer services activities represent between 22% and 52% of individual companies' CTS and, as set out in appendix G, £9.14 or 31.2% of ACTS as a whole. The costs, CTS and ACTS attributable to rows 1,2,3,7 and 8 are set out in appendix H.

Cost drivers used to allocate costs between wholesale and retail activities

The costs recorded in rows 1,2,3,7 and 8 are generally coded at source to cost centres and are not therefore allocated between wholesale and retail activities. On this basis, there is no cost driver used to allocate the costs included within these rows between wholesale and retail.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate retail costs between household and non-household customers is set out at appendix I. As can be seen, the drivers used are broadly similar across the sector and can be summarised as follows:

- Number of customers.
- Outstanding debt level (debt management and doubtful debts).
- Number of metered customers (meter reading).

Whilst the choice of drivers is similar, it is broadly the availability of information that drives the choice of cost driver that each company has adopted. For example, whilst the number of bills issued is considered to be the most representative driver of billing costs, many of the companies do not record the number of bills issued, hence, these companies have defaulted to number of customers as a proxy cost driver. The current guidance allows companies to select the driver it feels most representative to split retail costs between household and non-household activities. However, there is a trade-off between allowing the freedom of choice of cost driver and comparability.

We set out below the relative percentages allocated to household customers for the total of rows 1,2,3,7 and 8. It is reasonable to expect a range of percentages due to differences in household/non-household customer mix by each company. As can be seen the percentage of retail costs allocated to household ranges from 82% to 93%. The range is broadly consistent with the proportion of household customers in each company which ranges from 85% to 95%. On average the proportion of retail costs allocated to household customers was lower than the proportion of household customers (by 4%). In the main this is attributed to non-household customers being of higher value and requiring greater customer interaction, for example some companies have key-account teams allocated to large non-household customers.

Company	Percentage allocated to household for total of rows 1,2,3,7 and 8
ANH	87%
BRL	88%
CAM	86%
DVW	88%
NES	88%
NWT	82%
PRT	87%
SBW	86%
SES	92%
SEW	90%
SRN	89%
SST	91%
SVT	88%
SWT	89%
TMS	86%
VCE	91%
VEA	92%
VSE	89%
WSH	93%
WSX	88%
YKY	85%

Impact of inconsistencies upon CTS and ACTS

As set out above, all companies capture the costs of billing, payment handling, remittance and cash handling, debt management, non network customer enquiries and complaints and meter reading in separate cost centre(s), the total cost of which is budgeted for and managed separately throughout the year. The costs are coded directly at source and are not allocated between wholesale and retail activities. The treatment of these costs is, therefore, consistent across the sector. However, as set out in section 4.3.1 above, the underlying business structure adopted by the water companies may impact comparability as overhead costs can either be classed as direct costs (where core customer service activities are outsourced) or as general and support expenditure (where core customer service activities are undertaken in house).

For illustrative purposes, at appendix J, CTS in respect of G&S expenditure by company is set out together with whether the company outsources core customer services functions. As is apparent, the majority of companies that outsource customer functions have a lower CTS in respect of G&S expenditure.

Recommendations

- The structure underlying core customer service activity and whether related overheads are included as direct costs or general and support expenditures should be set out in the Methodology Statement to enable users to understand differences in the level of direct costs and general and support expenditure allocated to retail activities.

- Where overheads are included in direct costs, the percentage of direct costs that relate to overheads should be disclosed in the Methodology Statement where possible, for example, if the outsource provider is willing to disclose this information.

- In accordance with current guidance each company should select the cost driver that it feels most appropriate to allocate costs between household and non-household customers and the cost driver used should be disclosed within the Methodology Statement. However, in order to allow Ofwat to make comparisons each company should also be required to present the allocation between household and non-household customers on an alternative basis using the number of customers as the cost driver. Using this consistent basis should facilitate comparison (hereafter the 'household and non-household recommendation'). We consider that this alternative calculation should be performed within companies' business plans rather than on an annual basis in the regulatory accounts.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

6.3.2 Doubtful debt

The activities and related costs included in the Retail Table

Amounts included in row 4 of the Retail Table relate to the bad debt charge and bad debt provision, it is based on revenue amounts written off and amounts provided for during the year.

As set out in appendix G, £10.59 or 36.1% of the ACTS relates to doubtful debt and this amount ranges from £1.07 to £21.78 of the individual companies' CTS.

Cost drivers used to allocate costs between wholesale and retail activities

Doubtful Debt is coded at source to a cost centre and is not therefore allocated between wholesale and retail activities. On this basis, there is no cost driver used to allocate the costs included within these rows between wholesale and retail.

Allocation of retail costs between household and non-household customers

The basis used by each company to allocate retail costs between household and non-household customers is set out at appendix I. Whilst the terminology used both in Methodology Statements and at the company site visits varies it is apparent that doubtful debt has been allocated across household and non-household customers based upon the split of actual debt. On this basis, treatment across the sector is consistent.

Impact of inconsistencies upon CTS and ACTS

The extent to which companies invoice in the name of The Occupier and/or the different policies in respect of determining the date a property is vacated can both affect the level of doubtful debt within the Retail Table. We consider below the impact of these inconsistencies upon CTS and ACTS.

The outsourcing of billing and debt collection to a local authority where the local authority takes on the risk of bad debt may also affect the comparability of doubtful debt; however the effect of this incomparability is not modelled as it is not possible to determine what the doubtful debt charge would have been had the risk not been passed to the local authority.

Billing in the name of The Occupier

During the review, each company was asked whether it issues bills in the name of The Occupier and, where it does, how much of the doubtful debt charge included in the Retail Table for 2011/12 related to a write off or provision of income billed in the name of The Occupier.

Whether to bill in the name of The Occupier is a commercial decision taken by each water company and will be based upon, amongst other things:

- The level of usage.
- The cash generated from the activity set against the cost of issuing the invoice and chasing the debt.
- The fact that debt can only be legally recovered where the name of the user or occupier is known.

Ten companies issue bills in the name of The Occupier where water usage is identified, typically through a meter, but the occupier of the premises is unknown. NWT also issue bills in the name of The Occupier to unmetered properties.

We have modelled the impact of doubtful debt relating to The Occupier at appendix K. As can be seen the effect ranges from £0.03 to £0.13 of the individual companies' CTS and the effect on ACTS is £0.01.

It should be noted that the above calculation is based on responses provided by two companies. Other companies stated that they were unable to quantify the impact but noted that amounts billed to The Occupier were minimal as they had procedures in place to identify customers in order to send named bills.

Write off or write back of revenue for void properties

During the review, one of the water companies identified two different ways in which the industry accounted for revenue where one customer had been replaced by another at a particular property leaving a debt and the leaving date and whereabouts of the original customer was unknown.

The two different treatments identified are as follows:

- **Treatment 1:** It is assumed that the original customer vacated the property the day before the new customer moved in. Any outstanding debt is provided for as at the assumed date of vacation.
- **Treatment 2:** It is assumed that the original customer only resided at the property until the last date of contact (e.g., last date of payment, last date the original customer called the call centre, etc.). Bad debt at the point of last contact is provided for, however, income billed since the date of last contact is cancelled on the basis that the property was unoccupied or the occupier was unknown.

During the review, each company was asked which treatment it employs and if treatment 2 is used, the value of credit notes issued in respect of this circumstance during 2011/12. All companies stated that they employ treatment 1 except YKY which employs a variation of treatment 2 which resulted in its revenue for 2011/2012 being reduced by circa £642,000.

We have modelled the impact of YKY using treatment 2 at appendix AA. As can be seen the effect on YKY's CTS is an increase of £0.27 and ACTS overall increases by £0.02.

Recommendations

- To facilitate comparison, the Methodology Statement should include details of any outsourced functions including agreements with other water companies and local authorities. The percentage of income outsourced for billing and collection should also be included.
- The Methodology Statement should state whether or not bills are issued to The Occupier and if so, the amount of turnover and doubtful debt in respect of such bills for the year should be disclosed.
- To facilitate comparison, the Methodology Statement should state the policy for treatment of doubtful debt where the customer has vacated a property leaving amounts unpaid. Where credit notes are issued to cancel all or part of the unpaid amounts, the amount of the related credit notes should be disclosed.
- The household and non-household recommendation is as set out at section 6.3.1.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

6.3.3 Charitable trust donations

The activities and underlying costs included in the Retail Table

The cost of charitable trust donations is included in the Retail Table at row 5 and represents donations to charitable trusts that assist customers who are in need and poverty. The level of donations made is at the discretion of the water company and is not generally driven by volume or activity.

As set out in appendix G, £0.45 of the ACTS relates to charitable trust donations and this amount ranges from zero to £1.73 of the individual companies' CTS. At a maximum this represents 3.4% of NWT's CTS.

Cost drivers used to allocate costs between wholesale and retail activities

Charitable trust donations are coded to a cost centre and are not therefore allocated between wholesale and retail activities. On this basis, there is no cost driver used to allocate the costs between wholesale and retail.

Cost drivers used to allocate costs between household and non-household customers

Eight companies have recorded charitable trust donations for 2011/12 and in all cases the costs have been fully allocated to household.

Impact of inconsistencies upon CTS and ACTS

None.

Recommendations

None.

6.3.4 Network customer enquiries and complaints

The cost of responding to network customer enquiries and complaints is included in the Retail Table at row 10.

The activities and underlying costs included in the Retail Table

A key area which has lead to inconsistencies in the preparation of the Retail Table is the definition of this activity and the costs that should be included in the retail business unit. In all cases, the cost of the call centre which responds to network calls was included in the Retail Table. However, the treatment of the following activities differed between companies:

- The cost of a company employee or contractor attending customer's premises to determine the source of the problem (investigatory visits).
- The related cost of the time of the scheduling department in scheduling someone to attend the premises (where applicable).

The inclusion of the above costs within the Retail Table depends on the interpretation of the boundary between retail and wholesale. In some cases, these costs were included in the Retail Table either in row 10 or row 15 (Customer side leaks), and 13 companies have followed this treatment. In other cases the cost was deemed to be a network activity and had not therefore been reallocated to the Retail Table. Five companies have not included any of the cost of investigatory visits or scheduling department within the Retail Table.

As set out in appendix G, £1.12 of the ACTS relates to 'Network customer enquiries and complaints' and this amount ranges from £0.31 to £2.52 or 0.8% to 15.6% of the individual companies' CTS. We have modelled the impact of including investigatory visits and schedulers costs within retail for all companies below.

Cost drivers used to allocate costs between wholesale and retail activities

Where the cost of a company employee performing an investigatory visit was included in retail, this was generally determined by management estimate of employee time multiplied by a standard hourly rate that included a small element of related overhead (in relation to national insurance, pension, etc.) but did not include any corporate overheads (for example the cost of the premises in which the employee is based).

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate costs between household and non-household customers is set out appendix I. Broadly the drivers used are:

- Number of enquires.
- Number of customers/properties.

Where possible, the number of enquiries recorded in the billing system was used (4 companies). However the majority of companies stated that this information is not retained within the system and they have, therefore defaulted to the number of customers/properties.

Impact of inconsistencies upon CTS and ACTS

There is a difference in the interpretation of the boundary between retail and wholesale activities with respect to the cost of investigatory visits and scheduling costs. We have modelled the impact of including and excluding the cost of investigatory visits and scheduling within the Retail Table at appendix L (based on the average cost included for those companies who had allocated a proportion).

Where the cost of investigatory visits and scheduling costs are included for all companies (based on the average cost included for those companies who had allocated a proportion) the individual companies' CTS ranges from £0.55 to £2.52 and ACTS increases by £0.24. Where the cost of investigatory visits and scheduling costs are excluded the individual companies' CTS ranges from £0.31 to £1.85 and ACTS decreases by £0.25.

Recommendations

- IN12/01 states that Network customer enquiries and complaints should include costs that relate to "…*Receive, distribute, process, investigate and respond to enquiries*…". The company specific letter addressed to those companies that have not included the cost of investigatory visits and scheduling should bring to the company's attention that reported information is inconsistent with current guidance.

- The household and non-household cost driver recommendation is set out at section 6.3.1.

6.3.5 Services to developers

The activities and underlying costs included in the Retail Table

The cost of dealing with services to developers is included in the Retail Table at row 13. The cost relates to the time spent on activities relating to new developments, for example responding to developers' technical queries. Any related asset installation cost is capitalised and is not included within the Retail Table.

Costs relating to services to developers (row 13) by company can be seen in the analysis set out at appendix Y however these costs are excluded from the analysis in this section as they all relate to non-household activity and are not therefore included the calculation of CTS and ACTS. Furthermore costs relating to provision of connections to developers may be treated as wholesale costs from 2012/13 onwards based on our understanding of Ofwat's preferred definition of retail.

Cost drivers used to allocate costs between wholesale and retail activities

Costs in respect of services to developers are generally coded at source to a cost centre and are not therefore allocated between wholesale and retail activities. On this basis, there is no cost driver used to allocate the costs included within this row between wholesale and retail.

Cost drivers used to allocate costs between household and non-household customers

Given that developers are business customers, they are considered a non-household activity and costs are fully allocated to non-household customers.

Impact of inconsistencies upon CTS and ACTS

Services to developers are a non-household activity and are not, therefore, included within CTS or ACTS.

Recommendations

Based on our understanding of Ofwat's preferred definition of retail, the provision of connections to developers may be classed as a wholesale activity in the future and only customer-facing activities would be classed as retail. On this basis no recommendations are made.

6.3.6 Customer-side leaks

The activities and underlying costs included in the Retail Table

The costs of dealing with customer side leaks are included in the Retail Table at row 15 and relate to the cost of time spent repairing leaks on assets that are owned by the customer. In some instances, this service is offered for free.

As set out in appendix G, £0.67 of ACTS relates to customer-side leaks. SBW and WSH have not recorded any cost within the Retail Table.

- SBW has included costs that relate to customer side leaks within other direct costs.

- WSH stated that they did not incur any costs in respect of customer side leaks.

Cost drivers used to allocate costs between wholesale and retail activities

Costs in respect of the repair of customer leaks are generally coded at source to a cost centre and are not therefore allocated between wholesale and retail activities. On this basis, there is no cost driver used to allocate the costs included within this row between wholesale and retail.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate retail costs between household and non-household customers is set out at appendix I. Five cost drivers are used to allocate costs in respect of customer side leaks between household and non-household customers:

- Number of customers/number of properties (used by 10 companies)
- Identified separately using management information (used by four companies)
- Number of bills (used by one company)
- Allocated fully to household (used by three companies)
- Number of metered customers (used by three company)

Impact of inconsistencies upon CTS and ACTS

As customer side leaks only make up 2.3%, or £0.67 of ACTS, the impact of any inconsistencies in the allocation between wholesale and retail are not modelled.

Recommendations

The company specific letter addressed to SBW should bring to the company's attention that the cost of customer side leaks is reported within 'other direct costs and therefore reported information is inconsistent with current guidance

The household and non-household recommendation is as set out at section 6.3.1.

6.3.7 Other direct costs

The activities and underlying costs included in the Retail Table

Other direct costs are included in the Retail Table in row 16. Costs within this category include insurance, customer relations (e.g., producing customer leaflets), customer compensation payments and costs relating to emergency planning/disaster recovery.

As set out in appendix G, £0.27 of the ACTS relates to other direct costs and this amount ranges from zero to £1.45 of the individual companies' CTS. The level of other direct costs does however have an impact on the following company's CTS as set out below:

- The CTS for YKY is £0.82. This results from the inclusion of £1.1m of costs in respect of customer relations (e.g., Producing customer leaflets).
- The CTS for AFW is £1.45. An analysis of this costs was not provided.
- The CTS for SEW is £0.96. This is due to inclusion of insurance costs and the cost of printing customer leaflets which other companies have generally treated as G&S expenditure.
- The CTS for SES is £0.94. This is due to inclusion of insurance costs and the cost of printing customer leaflets which other companies have generally treated as G&S expenditure.

Cost drivers used to allocate costs between wholesale and retail activities

Other direct costs are generally coded to a separate cost centre throughout the year. As such they are direct costs and are not allocated based on a cost driver.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate retail costs between household and non-household customers is set out at appendix I. The drivers used to allocate costs in respect of other direct costs between household and non-household customers are set out below:

- ► Number of customers/number of properties (used by 12 companies)
- ► Number of bills (used by 1 company)
- ► Other drivers, e.g., management estimate (used by 6 companies)

Impact of inconsistencies upon CTS and ACTS

As other direct costs only make up 0.9%, or £0.27 of ACTS, the impact of any inconsistencies in the allocation between wholesale and retail are not modelled.

Recommendations

- ► The Methodology Statement should set out an analysis of the cost categories/values included within other direct costs to facilitate comparison.
- ► An information notice should be issued prior to submission of 2013/14 accounting separation data which states insurance costs should be included within G&S expenditure.
- ► The household and non-household recommendation is as set out at section 6.3.1.

6.3.8 Other costs included within direct costs

The activities and underlying costs included in the Retail Table

As set out above, at appendix G, we have disaggregated the CTS by company and the ACTS overall to determine the impact or otherwise of values reported by groups of row headings within the Retail Table. For the purposes of this analysis the following rows are aggregated on the basis that the total ACTS for the following rows (where included in Ofwat's ACTS model) is only 1.4% of ACTS. Differing treatment was identified for some of the costs as follows:

Row 6: Vulnerable customer schemes: Donations to vulnerable customer schemes are discretionary which accounts for some companies having a cost in this row and others not.

Row 9: Meter maintenance/installation non-capex: Whilst some companies have included costs on this row, the majority of companies capitalise meter maintenance/installation costs. The costs relating to meter maintenance may be treated as wholesale costs from 2012/13 onwards based on our understanding of Ofwat's preferred definition of retail. Therefore this cost in not included with CTS or ACTS.

Row 11: Disconnections: Disconnections costs are categorised as:

- ► Customer requested disconnections
- ► Disconnection due to non payment
- ► Other disconnections

The inclusion of costs relating to disconnections varied from company to company. 15 companies have included disconnections due to non payment within the Retail Table, however others have not reallocated the cost from wholesale to retail. The cost of physically disconnecting customers may be treated as wholesale costs from 2012/13 onwards based on our understanding of Ofwat's preferred definition of retail. Therefore this cost in not included with CTS or ACTS.

Row 12: Demand side water efficiency initiatives: This row includes the costs of the time spent by company employees who provide information to customers in respect of improving water efficiency. All companies have treated this as a retail activity and cost.

Row 14: Support for trade effluent compliance: This row includes the cost of advice to non-household customers as to how to comply with trade effluent restrictions. As set out in section 6.3, costs relating to support for trade effluent compliance relate to non-household activity and are not therefore included the calculation of CTS and ACTS.

Cost drivers used to allocate costs between wholesale and retail activities

The costs set out in rows 6, 9, 11, 12 and 14 are generally coded to a separate cost centre throughout the year. As such they are direct costs and are not allocated based on a cost driver.

Costs that relate to disconnections (row 11) have in some instances been allocated across wholesale and retail activities. Where the cost of the company employee who disconnected a property was included in retail, this was generally determined by management estimate of employee time or timesheet hours multiplied by a standard hourly rate that included a small element of overhead (in relation to national insurance, pension, etc.) but did not include any corporate overheads. All other costs relating to disconnections were reported as a wholesale activity.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate retail costs between household and non-household customers is set out at appendix I. Generally, costs for each activity set out above are allocated using the number of customers, however:

- ► As support for trade-effluent compliance is considered a non-household activity, costs have been allocated in full to non-household customers.
- ► As vulnerable customer schemes are considered household activities, costs have been allocated in full to household customers.

Impact of inconsistencies upon CTS and ACTS

As the total of other costs included within direct costs (rows 6 and 12) only make up 1.4%, or £0.40 of ACTS, the impact of any inconsistencies in the allocation between wholesale and retail are not modelled.

Recommendations

None.

6.3.9 General and support expenditure

G&S expenditure is included in the Retail Table at row 18 and represents £3.12 or 10.6% of ACTS. The G&S expenditure element of each company's CTS ranges between £0.36 and £7.79 or 1.6% and 45.1%. Based on the grouping of activities in this report G&S expenditure is the fourth largest component of ACTS (as can be seen in appendix G).

The activities and underlying costs included in the Retail Table

G&S expenditure represents the costs of shared activities that support both the wholesale and retail functions. The review highlighted that G&S expenditure is coded to separate cost centres in the general ledger system and whilst narrative varied, the following costs are typically included within G&S expenditure:

- Shared Director costs (including MD, etc.).
- Information Technology (IT) costs (including software licences, help desk and IT support).
- Human resources department.
- Finance department (including financial accounting, treasury, management accounting).
- Facilities management and shared premises costs.
- Other shared costs including insurance (where not included in other direct costs), procurement, PR and communications, legal.

During the review, companies were specifically asked about the inclusion of premises and particularly shared premises costs within the Retail Table. Generally companies had included customer services premises costs and also an element of shared premises costs.

Different interpretations as to what should be treated as G&S expenditure can result in incomparability between companies. During the review it was apparent that some companies had interpreted the guidance for G&S expenditure to include more activities. For example, TMS has included £0.3m of regulation costs as G&S expenditure whereas other companies have treated this cost as ‘other business activities’. We note the 2011/12 activity definitions specified that regulation costs should be included in ‘other business activities’.

The different presentation of these costs does not impact each companies’ CTS or the ACTS overall as the cost is included either way. However, the difference in treatment does make comparison of G&S expenditure in isolation (as reported in row 18) inconsistent between companies.

During the review, a number of inconsistencies in the inclusion of costs within G&S were identified. For illustrative purposes, at appendix M, we remodel retail cost as a percentage of total cost for G&S expenditure only. As this adjustment is a reclassification within the Retail Table, there is no impact on ACTS.

Furthermore, the outsourcing of core customer service activities can also result in differences in the level of overhead costs included within G&S expenditure. For example, where a retail activity is outsourced to a third party, the related overhead incurred by the third party will be treated as a direct cost within the Retail Table. By comparison, a company that operates the same function ‘in house’ that incurs a similar level of overhead costs will report higher G&S expenditure.

This inconsistency is complicated further by the outsourcing of retail functions to group/or associated companies. Depending upon the structure in place, overhead activities (e.g., HR, finance, etc.) may be procured by the outsourced provider from third parties or from the water company itself or from both.

[Paragraph redacted]

Where activities are outsourced to third parties, the level of overhead included in the charge for the service is not transparent. Arguably this is commercial pricing data that would not typically be shared with a customer.

[Paragraph redacted]

Cost drivers used to allocate costs between wholesale and retail activities

The shared nature of costs falling into the definition of G&S expenditure means that virtually all G&S expenditure within the Retail Table is allocated and not coded directly throughout the year. Moreover, the current guidance gives each company the freedom to choose the most appropriate driver for its structure and operations. We consider that whilst in theory this should result in the most representative allocation of costs it makes comparability more difficult.

It is apparent from the review that all companies undertake analysis of total G&S expenditures by category or cost centre to identify costs that relate solely to a particular business unit or group of business units. Examples of such costs include software licences for IT systems supporting specific business units (e.g., GIS system is considered as wholesale system whereas the billing system is considered to be a retail system). Where such costs are identified, these are deducted from the total G&S expenditure and allocated 100% to the relevant activity before the balance is allocated according to a selected cost driver. Whilst it is reasonable that this is done as ultimately the end result will be more representative of the activity underlying the cost, it makes comparison of G&S expenditures very difficult without extensive disclosure of the basis used for each cost allocated. Even with this disclosure, the extent of calculations that would need to be undertaken is prohibitive.

Furthermore, it is also apparent from the review that whilst shared costs are reviewed by each company and allocated across business units, some companies failed to allocate certain G&S expenditures to the Retail Table. For illustrative purposes, at appendix O, we set out the effect of some of the omissions identified during the review.

An analysis of the cost drivers used to allocate G&S expenditure by company is set out at appendix P. It was apparent that whilst narrative varied, all companies had generally defaulted to some measure of employee numbers/costs to allocate the majority of G&S expenditure on the basis that it is the number of employees that drive G&S expenditures. These cost drivers together with relative advantages and disadvantages are as follows:

- **Total direct costs:** Aside from capital expenditure, water companies are predominantly people based businesses and total direct costs, therefore, principally relate to wages and subcontractor costs, direct costs should be representative of the proportion of employees across wholesale and retail activities (costs relating to the wholesale business often being capital in nature). However, the inclusion of significant non people costs such as power in wholesale and doubtful debts in retail may skew proportions based on total direct costs.

- **Direct employment costs:** Employment cost can be considered as a better measure than direct cost as it does not include significant ‘non people’ costs. However, again, any proportions calculated on this basis may be skewed as there is not necessarily a one to one relationship between costs and the number of employees because remuneration rates are not consistent across grades and roles.

- **Number of employees:** The number of employees (either FTE or headcount) is more representative measure as it is not skewed by any of the factors set out above.[7]

Cost drivers used to allocate costs between household and non-household customers

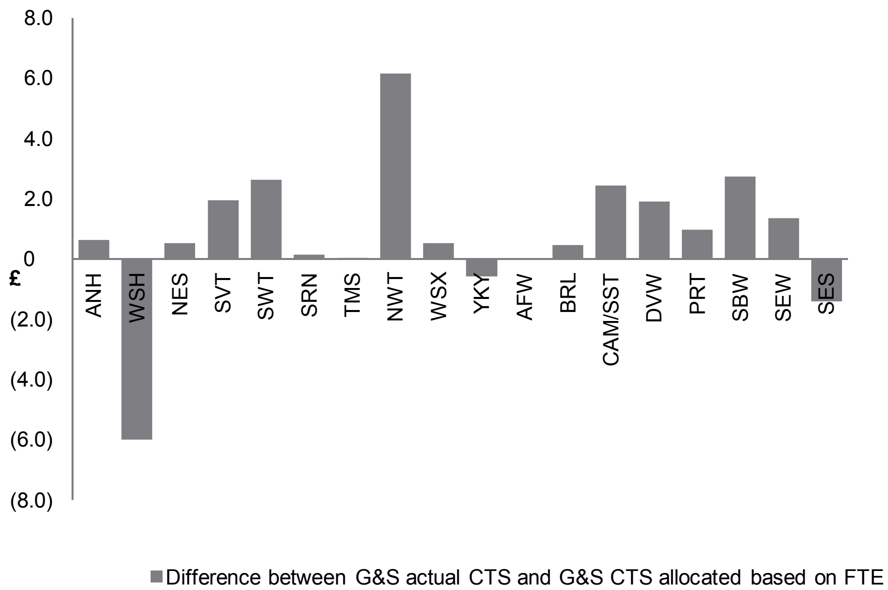
The basis used by each company to allocate retail costs between household and non-household activities is set out at appendix I. As can be seen, G&S expenditure is generally allocated on the basis of customer numbers in each category.

[7] As described in section 3.6 in the electricity industry employee numbers were used (along with other measures) to allocate corporate costs.

Impact of differences in comparability upon CTS and ACTS

As set out above, it was apparent that whilst narrative varied, all companies had generally defaulted to some measure of employee numbers/costs to allocate the majority of G&S expenditure on the basis that it was the number of employees that drive overheads.

For illustrative purposes, we set out below the difference between each company's CTS which is attributable to the actual G&S expenditure reported for 2011/12 and the G&S expenditure restated to be allocated based on FTEs.



The data used to prepare this graph is set out at appendix Q. AFW has not provided FTE data which is why there is no difference on the above graph.

Observations in respect of the graph above are as follows:

- The CTS for WSH based on FTEs is lower than its original CTS. This is because a large proportion of WSH's G&S expenditure relates to the recharge of Veolia overheads and is therefore correctly allocated directly to retail.

- The CTS for NWT based on FTEs is higher than its original CTS. This is because a proportion of NWT's G&S expenditure relates to direct wholesale costs and is therefore allocated directly to wholesale.

Recommendations

- Comparability of G&S expenditure across the sector is virtually impossible without full disclosure and extensive detailed analysis, particularly as the current guidance allows companies to select the driver it feels most representative of the activity driving each cost. There is a trade-off therefore between allowing the freedom of choice of cost driver and the resulting level of disclosure required to allow meaningful comparison and the accuracy of CTS and ACTS. For example, if companies are given the freedom of choice of cost driver, extensive disclosure of the breakdown of G&S expenditure and the cost drivers selected to allocate it will be required. Furthermore, the reader will need to undertake extensive analysis in order to restate each company's CTS on a consistent basis. Alternatively, a cost driver could be mandated for all companies but this alternative means that the cost allocated to the Retail Table may not be representative of the activities underlying it.

In accordance with current guidance each company should select the cost driver that it feels most appropriate to allocate G&S expenditure between wholesale and retail and the cost drivers used should be disclosed within the Methodology Statement. However, in order to allow Ofwat to make comparisons each company should also be required to present the allocation for G&S expenditure that is not directly attributed between wholesale and retail on an alternative basis using the number of employees (FTEs).[8] We consider that this alternative calculation should be performed within companies' business plans rather than on an annual basis in the regulatory accounts.

To aid comparability, the Methodology Statement should also set out:

- Which functions are outsourced and whether outsourced functions are undertaken by associated companies and/or third parties. Where outsourced functions are carried out overseas this should also be stated as the resulting differences in costs may also be significant.
- Whether overheads relating to outsourced functions are included as direct costs or as part of G&S expenditure.

- The household and non-household recommendation is as set out at section 6.3.1.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

6.3.10 Scientific services

The activities and underlying costs included in the Retail Table

Costs relating to scientific services are included in the Retail Table at row 19 and broadly represent the cost of laboratories, the cost of the scientific services team and the cost of sampling.

As set out in appendix G, £0.14 of the ACTS relates to scientific services and this amount ranges from zero to £0.93 of individual companies' CTS.

Cost drivers used to allocate costs between wholesale and retail activities

Costs relating to scientific services are generally coded to a separate cost centre throughout the year. The total cost is then allocated between wholesale and retail activities using number or cost of samples or management estimate.

There is an interpretational difference as to what sampling costs should be included in the Retail Table. Whilst some companies have included costs that relate to routine samples collected at customer taps, others have only included the sampling costs where a customer specifically requested a sample.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate scientific services costs between household and non-household activities is set out at appendix I. As can be seen, scientific services costs are generally allocated on the basis of customer numbers.

[8] As described in section 3.6 in the electricity industry a specified basis of allocation was used to allocate corporate costs (CSC 194).

Impact of inconsistencies upon CTS and ACTS

For illustrative purposes, at appendix S the CTS for those companies that had not allocated scientific services costs to retail is amended (based on the average cost included for those companies who had allocated a proportion) and revised ACTS calculated. Overall, the ACTS in respect of scientific services increased from £0.14 to £0.44.

Recommendations

- An information notice should be issued prior to submission of 2013/14 accounting separation data that sets out what types of sampling activity should included within retail.
- The household and non-household recommendation is as set out at section 6.3.1.

6.3.11 Other business activities

The activities and underlying costs included in the Retail Table

Costs included in other business activities are included in the Retail Table at row 20 and typically include the cost of the regulation department and the licence cost (for example Ofwat licence).

As set out in appendix G, £0.16 of the ACTS relates to other business activities and this amount ranges from zero to £0.62 of the individual companies' CTS.

Cost drivers used to allocate costs between wholesale and retail activities

The costs of the regulation department and licences are coded to separate cost centres throughout the year. The total cost is then generally allocated equally across business units in accordance with earlier guidance. There is confusion however over how many business units there are and this influences the amount of cost allocated to retail. For example, many WaSCs have allocated 1/9 of the cost on the basis that there are 8 wholesale business units and 1 retail unit. WSH has classed retail as two units (household and non-household) and has therefore allocated 2/10 to retail. Similarly many WOCs have allocated 1/5 of the cost on the basis that there are 4 wholesale business units and 1 retail business unit however VEA has classed retail as two units (household and non-household) and has therefore allocated 2/6 to retail. Although Ofwat did not provide specific guidance on business units for 2011/12, the guidance for the 2010/11 accounting separation data stated that retail is to be treated as one business unit.

Furthermore, ANH and TMS have not included an allocation of other business activities within row 20. However TMS has included regulation costs in G&S expenditure and has allocated an amount to retail within the G&S expenditure row.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate other business activities costs between household and non-household customers is set out at appendix I. As can be seen, other business activity costs are generally allocated on the basis of customer numbers.

Impact of inconsistencies upon CTS and ACTS

For illustrative purposes, at appendix T the CTS for those companies that had not allocated other business activity costs to retail is amended (where appropriate) and revised ACTS calculated. Overall, the ACTS in respect of other business activity costs increased from £0.16 to £0.17.

Recommendations

- An information notice should be issued prior to submission of 2013/14 accounting separation data which states whether retail is one business unit or two.
- The household and non-household recommendation is as set out at section 6.3.1.

6.3.12 Local authority rates

The activities and underlying costs included in the Retail Table

Costs relating to local authority rates are included in the Retail Table at row 22. Generally costs included in this row relate to the Cumulo charge which is based on profits, and business rates for sewerage sites which are assessed separately. There is different interpretation as to whether head office and other administration sites should be included in this row with some companies including such costs in row 22 and others including such costs as part of G&S expenditure.

As set out in appendix G, £0.17 of the ACTS relates to local authority rates and this amount ranges from zero to £0.82 of the individual companies' CTS.

Cost drivers used to allocate costs between wholesale and retail activities

Where rates are paid as part of the Cumulo charge, the cost has generally been allocated based on Gross Modern Equivalent Asset Values (MEAV). In some cases the assets allocated to the Retail Table are brought in as part of this allocation and on this basis, a proportion of the Cumulo charge is allocated to retail.

Non cumulo rates are allocated according to the following drivers:

- Asset value (used for 13 companies).
- Floor space (used by 3 companies).
- Number of employees (used for 2 companies).
- Direct costs (used by 1 company).

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate local authority rates between household and non-household customers is set out at appendix I. As can be seen, local authority rates costs are generally allocated on the basis of customer numbers.

Impact of inconsistencies upon CTS and ACTS

As local authority rates only make up 0.6%, or £0.17 of ACTS, the impact of any inconsistencies in the allocation between wholesale and retail are not modelled.

Recommendations

- The company specific letter addressed to those companies that have not included the cost of local authority rates should bring to the company's attention that reported information is inconsistent with current guidance.
- The Methodology Statement should set out which types of rates have been allocated to the Retail Table, on what basis and in what row they are included.
- The household and non-household recommendation is as set out at section 6.3.1.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

6.3.13 Exceptional items

The activities and underlying costs included in the Retail Table

Costs relating to exceptional items are included in the Retail Table at row 23. By their very nature, exceptional costs vary from year to year and by company. In 2011/12, the following costs were included in exceptional items:

- One off pension costs and credits.
- Expenditure to improve leakage performance following two severe winters.
- The costs of an ongoing restructuring programme.

Cost drivers used to allocate costs between wholesale and retail activities

The costs of exceptional items are coded to separate cost centres. The total cost is then allocated between wholesale and retail activities using a relevant driver which varies from year to year and by company according to the cost being allocated. For example in 2011/12, the following drivers were used:

- Employment costs.
- Current pension allocation.

Cost drivers used to allocate costs between household and non-household customers

The basis used to allocate the costs of exceptional items may vary from year to year and by company according to the cost being allocated. For example in 2011/12, the following drivers were used:

- Number of customers.
- Allocated to household.

Impact of inconsistencies upon CTS and ACTS

As set out in appendix G -£0.06 of the ACTS relates to exceptional items. Due to the one off nature of these types of costs, the impact of any inconsistencies in the allocation between wholesale and retail are not modelled.

Recommendations

- The Methodology Statement should set out an analysis of the cost categories/values included within exceptional items.
- The household and non-household recommendation is as set out at section 6.3.1.

The recommendation in respect of disclosure within the Methodology Statement and how it should be implemented is set out in section 7.

6.3.14 CCD

As set out in section 5, CCD is included in the Retail Table at row 28. The CTS attributable to CCD (and amortisation of intangible assets) ranges from zero to £8.00 and represents £3.16 or 10.8% of the ACTS.

According to Ofwat's ACTS model, CCD is total retail household CCD from the Retail Table less household CCD in respect of meters (per ST7). Ofwat has informed us that in some cases the deduction of household CCD in respect of meters from total retail household CCD resulted in a negative amount which has been limited to £nil within the model. On this basis CCD reported in ST7 appears to be unreliable.

To demonstrate the relative significance of the different elements of CCD within retail, at appendix U, the CTS attributable to CCD is disaggregated into the following categories:

- The billing system.
- Other assets directly allocated to the Retail Table (e.g., fixtures and fittings, etc.).

- Assets that are shared across retail and wholesale functions.

The assets and underlying costs included in the Retail Table

As set out at section 5, it was apparent that a number of companies are unable to easily identify CCA net book value and depreciation for assets allocated in full or in part to the retail business unit. However, where companies were able to provide this analysis the following categories of assets and underlying costs were identified.

The billing system

All companies have allocated the costs of the billing system wholly to the retail function with the exception of NES, VCE, TMS and PRT:

- NES and VCE have treated the billing system as a shared asset. However, the 2011/12 guidance states that *"....retail includes the following assets...billing system..."* On this basis, it appears that the treatment adopted by NES and VCE is inconsistent with current guidance.

- TMS and PRT have not included any CCD in respect to their billing systems as both stated that the asset was fully depreciated. However para 1.7.3 of RAG1.05 states that *"…The CCA value of tangible assets to a business means what potential competitors would find it worth paying for them in the absence of barriers to entry and exit from the business … This will be the cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued – a Modern Equivalent Asset (MEA) – if the asset would be worth replacing, or the recoverable amount if it would not…"* It is reasonable therefore to expect each company to include a value for CCD in respect of a billing system. On this basis, it appears that the treatment adopted by TMS and PRT is inconsistent with current guidance.

WSH has included CCD within the Retail Table however this amount is not apparent due to rounding.

Other assets directly allocated to the Retail Table

Other assets directly allocated to the Retail Table include the telephony system (to the extent that a separate system is used purely for the customer contract centres) and also fixtures and fittings, other specialised IT software, etc.

Assets that are shared by across retail and wholesale functions

Assets that are shared across retail and wholesale functions include:

- Finance software (e.g., SAP, Oracle, etc.), other business support software and telephony equipment.

- Leasehold and freehold property including Head Office and other shared premises and operational buildings.

- Land.

- Vehicles including vans used by meter readers and investigators/customer service technicians.

Cost drivers used to allocate costs between wholesale and retail activities

CCD is derived from the CCA fixed asset register and is allocated between wholesale and retail activities using one of the following drivers:

- FTE.

- Proportion of accumulated depreciation.

Cost drivers used to allocate costs between household and non-household customers

The basis used by each company to allocate depreciation between household and non-household activities is set out at Appendix I. Whilst a number of different cost drivers have been used they can be categorised into measures based on asset values and measures based on customer statistics (customer numbers or bills issued).

Impact of inconsistencies upon CTS and ACTS

As set out above, the cost of the billing system is directly attributed to the Retail Table; however, NES and VCE have allocated a proportion of the billing system cost to wholesale. For illustrative purposes, at appendix V the CTS for NES is revised to reflect the billing system being treated as fully attributable to retail. The revised ACTS for CCD is also calculated and results in an increase of £0.01. The CTS for VCE has not been revised as the company did not provide the relevant information.

As set out above, TMS and PRT have not included a value for CCD in respect of their billing system and this treatment appears to be inconsistent with RAG1.05. As TMS and PRT have not calculated the value of CCD in respect of its billing system it is not possible to model the effect of this treatment.

Recommendations

- IN12/01 states that retail fixed assets includes "*…billing system…*" The company specific letter addressed to NES and VCE should state that this reported information is inconsistent with current guidance.
- As set out above, RAG1.05 requires the CCA value of tangible assets to be based on market value. The company specific letter addressed to TMS and PRT should state that this reported information is inconsistent with current guidance.
- The Methodology Statement should set out an analysis of the assets allocated to the Retail Table. The analysis should disaggregate the closing net book value (NBV) and CCD charge for the year into the following categories:
  - Billing System.
  - Other assets specifically allocated to the Retail Table.
  - Shared assets allocated to the Retail Table.
- The Methodology Statement should also set out the cost driver used to allocate shared assets between wholesale and retail.
- The Methodology Statement should also specify whether the company maintains a CCA register, the extent to which it is reconciled to the HCA fixed asset register and the methodology/assumptions undertaken to compile CCA data. This disclosure will aid comparability for the user of the Retail Table.
- Each company specific letter should draw attention to the fact that Ofwat considers the Retail Table to be important, as the information is to be used in the assessment of future prices, and reminds companies of their obligations in respect of the regulatory accounts and the risk and compliance statement.
- The household and non-household recommendation is as set out at section 6.3.1.

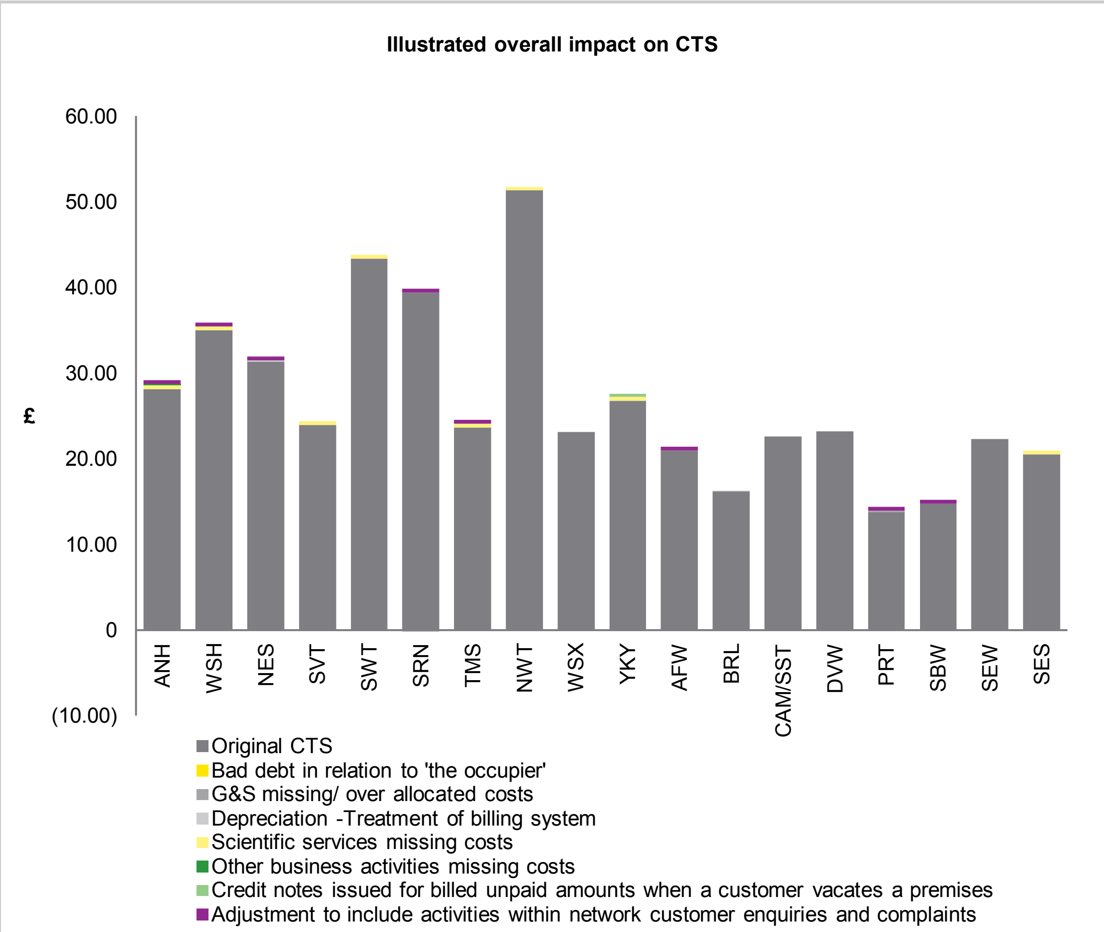
6.4 Overall impact of inconsistency identified on ACTS

As set out in this section, a number of inconsistencies have been identified that affect CTS and ACTS. These inconsistencies are as follows:

- Bad debt in relation to The Occupier (section 6.3.2).
- Interpretational differences – Network customer enquiries and complaints (section 6.3.4).
- G&S missing costs (section 6.3.9).
- Depreciation – Treatment of billing system (section 6.3.14).
- Scientific services (section 6.3.10).
- Other business activities (section 6.3.11).

For illustrative purposes, at appendix W we amend CTS for those companies where inconsistencies were identified and recalculate ACTS on the same basis. Overall, the ACTS increased from £29.31 to £29.39 where the cost of schedulers and investigatory work was excluded. Where these costs were included for all companies (based on the average cost included for those companies who had allocated a proportion) the ACTS increases to £29.88.

The impact on ACTS is shown graphically as follows:



7. Findings in relation to transparency

7.1 Introduction

In this section of the report we consider the transparency of data. In the context of the review transparency is the provision of information to allow users to determine the robustness and comparability of the reported data.

The way in which companies have provided disclosure to enable users to understand their reported accounting separation tables is principally the Methodology Statement. The Methodology Statement is a document published by each water company and provides commentary and background in respect of all tables including the Retail Table. Ofwat required publication of a Methodology Statement in 2009/10 and 2011/12. In this section we set out an overview of our observations on the information disclosed in the 2011/12 methodology.

7.2 Disclosure within the Methodology Statement

An analysis of the information disclosed in each company's Methodology Statement is set out at appendix X. It can be seen that there are differences in the quantity and nature of information provided in the Methodology Statement for 2011/12 across the industry.

Acknowledging that there is a limit to the degree of information that companies will be willing to disclose within the Methodology Statement we consider that there is a minimum level of disclosure required to achieve the objectives set out above. We set out our observations on the information disclosed in the 2011/12 Methodology Statement by reference to:

- Information disclosed to determine the robustness of data.
- Information disclosed to allow users to make comparisons between companies.

7.2.1 Information disclosed to determine the robustness of data

To determine the extent to which the reported data is robust and therefore accurately reflects underlying activities and related costs the Methodology Statement should set out the process undertaken to prepare the Retail Table including the governance process applied prior to the data being reported. Whilst it is apparent that the majority of companies have disclosed some information in respect of the process undertaken the overall process is not usually set out and therefore it is unclear as to all the individual stages of the process that have been followed.

Furthermore there are a number of differences in the interpretation of the information required to be disclosed in the Methodology Statement. For example 16 companies have provided an overview of the process undertaken, and some have set out the specific reports run within their accounting system and the name of documents containing cost driver information. Whilst this provides a degree of comfort over the rigour of the process, the nature of the information will not increase the ability of the user to form a view as to the robustness of the data reported in the Retail Table.

Disclosure in respect of the internal review and approval process would allow the user to determine the extent of any checking. Whilst in all cases there is some disclosure of the process, or part of the process, undertaken to prepare the Retail Table, in only in a small number of cases is there an overview of the internal review and approval processes to which the Retail Table were subjected.

In addition, it would be beneficial to the user to understand how the current year figures compare to the figures reported for the prior year and the reasons for any significant differences. Such differences will include both changes in costs, structure, and approach to the preparation of the Retail Table, e.g., changes in cost drivers. Only 4 companies have included such commentary within the Methodology Statement for the year 2011/12.

7.2.2 Information disclosed to allow users to make comparison between companies

To identify situations where costs relating to similar transactions are recognised and reported in a different way, in order for the user to make an informed **comparison** the Methodology Statement should disclose the following information:

- An overview of the underlying structure of the business.
- An explanation as to how shared costs have been allocated between retail and wholesale.
- The drivers used to allocate costs between household and non-household customers.

An overview of the underlying structure of the business

An overview of the underlying structure of the business provides context to the financial data reported in the Retail Table. As set out in section 6 the underlying structure of the business has an impact on comparability, particularly in respect of any outsourcing arrangements and the use of third parties to bill and collect debts. Whilst the review has highlighted that there are comments made in the Methodology Statement in respect of how elements of retail activities are managed, there is typically no separate section that sets out the underlying structure of the business.

An explanation as to how shared costs have been allocated between retail and wholesale

The review has highlighted that there are a number of differences in the disclosure of how G&S expenditure is allocated between retail and wholesale. Broadly, companies have disclosed the categories of G&S expenditure within the Methodology Statement however there is a lack of consistency in the categories of G&S expenditure set out. For example SVT has split the finance category into ‘financial performance team’, ‘treasury and tax team’ and ‘management accounts team’ whereas other companies have included all finance team costs within a single ‘finance’ category. Similarly there is inconsistent language used to describe cost drivers used to allocate G&S expenditure. For example where the number of employees is the cost driver, various terms are used including ‘FTE’, ‘Headcount’ and ‘Manpower numbers’. This inconsistency might mean that the user is unable to determine whether a comparison is meaningful.

Whilst it is apparent that the majority of companies have disclosed information in respect of how G&S expenditure has been allocated, the user is unable to identify for each category:

- Whether any direct costs have been included within G&S expenditure or whether any G&S expenditure has been included within direct costs. For example if marketing costs are included within ‘other direct costs’ and not included within G&S expenditure this should be set out in the Methodology Statement.
- The amount of G&S expenditure that was directly attributed to retail.
- The balance of G&S expenditure that was allocated to retail using a cost driver, and the percentage allocated to retail.

The drivers used to allocate costs between household and non-household customers

Whilst explanations as to how costs are allocated across the retail-wholesale boundary vary by company, the explanations as to how costs have been allocated between household and non-household are broadly consistent in the disclosure of the cost drivers used in the allocation of household/non-household.

7.2.3 Recommendation

IN 13/01 requires each company to publish an accounting separation Methodology Statement for the 2012-13 accounting separation data that includes the following minimum requirements:

- *Cost allocation bases (costs drivers) and any changes year on year.*
- *A breakdown of the recharges paid to and received from other business units for the use of fixed assets.*
- *Significant changes in costs in the year.*
- *Details of processes and systems and any changes year on year*
- *How the companies have applied the principles set out in RAG4.*
- *Any additional analysis or adjustments made to data from the systems.*
- *An explanation of the allocation basis used for each line of the table, why these allocation bases are considered appropriate and how management is satisfied that they are reasonable.*
- *Improvements that have been made to methodology in the year and any planned improvements in the coming year.*

The minimum information requirements set out above should be expanded to include the following:

- The structure underlying core customer service activity and whether related overheads are included as direct costs or G&S expenditure. Where overheads are included in direct costs, the percentage of direct costs that relate to overheads should be disclosed.
- For each row within the Retail Table the cost driver used to allocate costs between household and non-household.
- Details of any outsourced functions including agreements with other water companies and local authorities. The percentage of income outsourced for billing and collection should be included. Where outsourced functions are carried out overseas this should also be stated as the resulting difference in costs may also be significant.
- Whether or not bills are issued to The Occupier and if so, the amount of turnover and doubtful debt in respect of such bills for the year should be disclosed.
- The policy for treatment of doubtful debt where the customer has vacated a property leaving amounts unpaid. Where credit notes are issued to cancel all or part of the unpaid amounts, the full amount of the related credit notes should be disclosed.
- An analysis of the cost categories/values included within other direct costs.
- The cost drivers used to allocate G&S expenditure between wholesale and retail.
- The Methodology Statement should set out an analysis of G&S expenditure in seven categories: HR, IT, Finance, shared director costs, facilities and shared premises costs, insurance and other. Whilst a number of companies have disaggregated G&S expenditure into a higher number of categories (for example between 25-30 categories)

consistent disclosure of seven categories would benefit comparability across the sector.[9] For each category the Methodology Statement should set out, the amount directly attributed to retail and for the balance of expenditure the cost driver used to allocate between retail and wholesale. A suggested format for such disclosure is set out at appendix R.

- What types of local authority rates have been allocated to the Retail Table, the basis of inclusion and in what row they are included.
- An analysis of the cost categories/values included within exceptional items.
- An analysis of the assets allocated to the Retail Table. The analysis should disaggregate the closing net book value (NBV) and current cost depreciation (CCD) charge for the year into the following categories:
  - Billing System.
  - Other assets specifically allocated to the Retail Table.
  - Shared assets allocated to the Retail Table.
- The Methodology Statement should also set out the cost driver used to allocate shared assets between wholesale and retail.
- Whether the company maintains a CCA register, the extent to which it is reconciled to the HCA fixed asset register and the methodology/assumptions undertaken to compile CCA data.

An information notice should be issued which sets out the minimum information requirements for the Methodology statement going forward. These minimum requirements should include those set out in IN13/01 and the additional requirements set out above. The information notice should state the guidance supersedes any guidance previously issued and will remain in force until formally revoked. The revised information notice should be issued prior to the submission of the 2013/14 accounting separation data.

[9] Where companies disclose more than seven categories we recommend that they are aggregated under the seven headings even if they continue to perform the calculation at a more detailed level.

8. Recommendations

8.1 Introduction

In this section we draw together the recommendations that were identified in sections 4 to 7 based on the findings in respect of the robustness, consistency and transparency of data included within the Retail Table. As set out in section 3 we have categorised the recommendations into three broad areas as set out below:

- Assurance
- Guidance
- Disclosure

We discuss at a high level the categories of possible recommendation, their benefits and drawbacks and the situations where we consider they might be applicable in appendix F.

8.2 Assurance

We set out proposed recommendations in respect of internal and external assurance below. We consider that this assurance will serve to address stakeholder's perceptions of the robustness of the data.

8.2.1 Internal assurance

Each company specific letter should draw attention to the fact that Ofwat considers the Retail Table to be important, as the information is to be used in the assessment of future prices, and reminds companies of their obligations in respect of the regulatory accounts and the risk and compliance statement.

8.2.2 External assurance

The Retail Table and ST6 should be subject to agreed upon procedures to be performed by an external auditor. This requirement should be set out in an information notice to cover the 2013/14 accounting separation data. The agreed upon procedures which are set out below should be subject to a bipartite agreement between the company and the external auditor:[10]

- Obtain and read the Methodology Statement prepared by the water company to confirm it is in accordance with current guidance. Report exceptions.
- Walk through the process used to prepare the tables to determine it is in accordance the Methodology Statement. Report exceptions.
- Agree total operating expenditure per the Retail Table and total operating expenditure per the Wholesale Table(s) to total operating expenditure per the Regulated Accounts.
- Compare current year and prior year figures in the Retail Table, obtain explanations for significant movements (for example movements in excess of 10%).
- Agree Core Customer Services costs to the general ledger.
- Agree Doubtful Debts to the general ledger.
- For direct costs originally recorded as wholesale activities that have been reclassified to retail, understand the basis of reclassification and agree back to source data.

[10] Ofwat should consider whether it requires a 'duty of care' to be acknowledged by the auditor.

- Reperform all G&S cost allocation calculations using cost drivers set out in the Methodology Statement. For a sample of G&S expenditure agree the total cost to the general ledger and the cost data to source data.

- Reperform scientific services cost allocation calculations using cost drivers set out in the Methodology Statement.

- Reperform other business activities cost allocation calculations using cost drivers set out in the Methodology Statement. Agree total CCD per Retail Table to total CCD per ST6. Agree total CCD per ST6 to current cost fixed asset register.

- For a sample of M&G assets, understand the basis of allocation between retail and wholesale and agree back to source data and provide description of source data.

- For each row within the Retail Table, understand the basis of allocation between household and non-household and reperform the calculation using the cost drivers set out in the Methodology Statement. Agree the cost driver figure used in the calculation to source data.

8.3 Guidance

In proposing recommendations relating to guidance we have considered the extent to which Ofwat's existing guidance has been followed. Where we consider Ofwat's guidance is clear then the recommendation is that the findings of the review are addressed on an individual basis with the relevant company. In areas where we consider existing guidance to be unclear or no guidance exists the recommendation is that this is addressed with the sector as a whole. Our recommendations are as follows:

- The company specific letter addressed to those companies that have not included the cost of investigatory visits and scheduling should bring to the company's attention that reported information is inconsistent with current guidance.

- The company specific letter addressed to those companies that have not included the cost of local authority rates should bring to the company's attention that reported information is inconsistent with current guidance.

- IN12/01 states that retail fixed assets includes "*…billing system…*" The company specific letter addressed to NES should state that this reported information is inconsistent with current guidance.

- As set out above, RAG1.05 requires the CCA value of tangible assets to be based on market value. The company specific letter addressed to PRT and TMS should state that this reported information is inconsistent with current guidance.

- An Information Notice should be issued prior to submission of 2013/14 accounting separation data that states:

  - That insurance costs should be included within G&S expenditure.

  - What types of sampling activity should included within retail.

  - Whether retail is one business unit or two.

8.4 Disclosure

An information notice should be issued which sets out the minimum information requirements for the Methodology Statement going forward. These minimum requirements should include those set out in IN13/01 and the additional requirements set out below. The information notice should state the guidance supersedes any guidance previously issued and will remain in force until formally revoked. The revised information notice should be issued prior to the submission of the 2013/14 accounting separation data. The additional requirements are as follows:

- The business structure adopted by the company including the structure underlying core customer service activity and whether related overheads are included as direct costs or G&S expenditure. Where overheads are included in direct costs, the percentage of direct costs that relate to overheads should be disclosed.

- Details of any outsourced functions including agreements with other water companies and local authorities. The percentage of income outsourced for billing and collection should be included where the risk of collection is transferred to a third party. Where outsourced functions are carried out overseas this should also be stated as the resulting differences in costs may also be significant.

- Whether or not bills are issued to The Occupier and if so, the amount of turnover and doubtful debt in respect of such bills for the year should be disclosed.

- The policy for treatment of doubtful debt where the customer has vacated a property leaving amounts unpaid. Where credit notes are issued to cancel all or part of the unpaid amounts, the full amount of the related credit notes should be disclosed.

- An analysis of the cost categories/values included within other direct costs.

- The cost drivers used to allocate G&S expenditure between wholesale and retail.

- The Methodology Statement should set out an analysis of G&S expenditure that identifies seven categories: HR, IT, Finance, shared director costs, facilities and shared premises costs, insurance and other. Whilst a number of companies have disaggregated G&S expenditure into a higher number of categories (for example between 25-30 categories) consistent disclosure of seven categories would benefit comparability across the sector. For each category the Methodology Statement should set out, the amount directly attributed to retail and for the balance of expenditure the cost driver used to allocate between retail and wholesale. A suggested format for such disclosure is set out at appendix R.[11]

- What types of local authority rates have been allocated to the Retail Table, the basis of inclusion and in what row they are included.

- An analysis of the cost categories/values included within exceptional items.

- An analysis of the assets allocated to the Retail Table. The analysis should disaggregate the closing net book value (NBV) and current cost depreciation (CCD) charge for the year into the following categories:

  - Billing System.

  - Other assets specifically allocated to the Retail Table.

  - Shared assets allocated to the Retail Table.

- The Methodology Statement should also set out the cost driver used to allocate shared assets between wholesale and retail.

- Whether the company maintains a CCA register, the extent to which it is reconciled to the HCA fixed asset register and the methodology/assumptions undertaken to compile CCA data.

[11] Where companies disclose more than seven categories we recommend that they are aggregated under the seven headings even if they continue to perform the calculation at a more detailed level.

- For each row within the Retail Table the cost driver used to allocate costs between household and non-household customers.

Companies apply different cost drivers to allocate general and support costs between wholesale and retail business units and to allocate retail costs between household and non-household customers. Allowing discretion in the choice of cost driver should enable companies to apply a measure that results in an allocation that is representative of the underlying costs. However, to enable Ofwat to make comparisons we consider companies should be required to present their allocated costs on an alternative prescribed basis within their business plans.[12] The proposed cost drivers we recommend for each area are:

- Allocation of general and support costs between retail and wholesale: Full Time Equivalents.

- Allocation of retail costs between household and non-household customers: Number of customers.

8.5 Impact on previously reported data

- Given the findings of the review we, other than for Affinity Water, do not consider that there are any areas where previously reported data should be restated.

  As set out in section 2.3 Affinity Water were unable to provide any detailed information is respect of Veolia South East as the relevant employees have left following its acquisition. We understand that it is Affinity Water's intention that the accounting separation data for the former three Veolia companies will be prepared for 2012/2013 on a consolidated basis. Given this and the absence of supporting information and explanations for 2011/12 (discussed above) we recommend that, for comparability, Affinity Water restates the 2011/2012 accounting separation data on a consolidated basis for all three companies on the same basis as that used for 2012/2013.

  We recommend that the restated 2011/12 data is included in the regulatory accounts and is subject to the regulatory accounts audit opinion. Furthermore we recommend that Affinity Water management confirm in the regulatory accounts that the restated 2011/12 data has been prepared on a consistent basis with the reported 2012/13 data.

- Where we have recommended additional disclosure or disaggregation of balances within future reported data Ofwat should consider whether companies should provide similar disclosure or disaggregation in relation to previous years for comparability purposes.

- Based on the findings of the review consideration should be given to companies that did not include the costs of investigatory visits following Network customer enquiries and complaints stating what the cost of those visits would have been in previously reported data. The impact of the additional costs that should have been included in the Retail Table in 2011/12 should be disclosed in the 2012/13 regulatory accounts but because of the relatively small impact on ACTS we do not consider that there should be a restatement of the 2011/12 reported information.

[12] Costs directly attributed to an activity should continue to be recorded as such.

Appendix A List of companies

In 2011/12 there were 21 water companies as set out below:

Company	Abbreviation	Company type	Site visit
Anglian Water Services Ltd	ANH	WaSC	06/02/13
Northumbrian Water Ltd	NES	WaSC	29/01/13
United Utilities Water plc	NWT	WaSC	08/02/13
Southern Water Services Ltd	SRN	WaSC	28/02/13
Severn Trent Water Ltd	SVT	WaSC	22/01/13
South West Water Ltd	SWT	WaSC	15/02/13
Thames Water Utilities Ltd	TMS	WaSC	28/01/13
Dŵr Cymru Cyfyngedig (Welsh Water)	WSH	WaSC	11/02/13
Wessex Water Services Ltd	WSX	WaSC	04/02/13
Yorkshire Water Services Ltd	YKY	WaSC	14/02/13
Bristol Water plc	BRL	WOC	18/02/13
Cambridge Water Company plc	CAM	WOC	19/02/13
Dee Valley Water plc	DVW	WOC	25/02/13
Portsmouth Water plc	PRT	WOC	22/02/13
Sembcorp Bournemouth Water Ltd	SBW	WOC	12/02/13
Sutton and East Surrey Water plc	SES	WOC	04/03/13
South East Water Ltd	SEW	WOC	28/02/13
South Staffordshire Water plc	SST	WOC	05/02/13
Veolia Central (Three Valley)	VCE	WOC	
Veolia East (Tendring Hundred)	VEA	WOC	26/02/13
Veolia South East (Folkestone & Dover)	VSE	WOC	

Since 2011/12 South Staffordshire Water plc has acquired Cambridge Water Company plc and the three Veolia companies have merged and to become Affinity Water, reducing the number of companies to 18. Separate meetings were held with CAM and SST and one meeting was held with VCE, VEA and VSE.

On this basis for the purposes of restating CTS and ACTS, 18 companies have been considered.

Appendix B Sources of information

For each of the 21 water companies as set out in appendix A:

- The 2011/12 tables as follows:
  - 1 – Regulatory accounts (CCA) – Activity costing analysis; Water service – 2
  - 2 – Regulatory accounts (CCA) – Activity costing analysis; Retail services
  - 3 – Regulatory accounts (CCA) – Activity costing analysis; sewerage service – 2 (WaSCs only)
  - 4 – Regulatory accounts (CCA) – Analysis of fixed assets by business unit; water service
  - 5 – Regulatory accounts (CCA) – Analysis of fixed assets by business unit; sewerage service (WaSCs only)
  - 6 – Regulatory accounts (CCA) – Analysis of fixed assets by business unit; retail service
  - ST7: Meters
- The 2011/12 accounting separation Methodology Statements
- The 2011/12 regulatory and statutory accounts
- Responses (where applicable) to the following consultation
  - Future price limits – a preliminary model: informal consultations:
  - Consultation on changes to regulatory accounting guidelines (RAGs)
  - Retail price controls for the 2014 price review
- Additional, information shared during site visits

Appendix C Retail services – table 2 template

Line	Description	Unit	Retail household	Retail household and support memo	Retail non-household	Retail non-household general and support memo	Retail services total
Service analysis – retail							
A	**Direct costs**						
1	Billing	£m					
2	Payment handling, remittance and cash handling	£m					
3	Debt management	£m					
4	Doubtful debts	£m					
5	Charitable trust donations	£m					
6	Vulnerable customer schemes	£m					
7	Non-network customer enquiries and complaints	£m					
8	Meter reading	£m					
9	Meter maintenance/installation non-capex	£m					
10	Network customer enquiries and complaints	£m					
11	Disconnections	£m					
12	Demand-side water efficiency initiatives	£m					
13	Services to developers	£m					
14	Support for trade effluent compliance	£m					
15	Customer-side leaks	£m					
16	Other direct costs	£m					
17	Total direct costs	£m					
B	**Operating expenditure**						
18	General and support expenditure	£m					
19	Scientific services	£m					
20	Other business activities	£m					
21	Total business activities	£m					
22	Local Authority rates	£m					
23	Exceptional items	£m					
24	Total opex less third party services	£m					
25	Third party services	£m					
26	Total operating expenditure	£m					
C	**Capital maintenance**						
27	Infrastructure renewals charge (excluding third party services)	£m					
28	Current cost depreciation	£m					
29	Amortisation of deferred credits	£m					
30	Amortisation of intangible assets	£m					
31	Total capital maintenance	£m					
32	Total operating costs	£m					

Appendix D Limitations in relation to information

Company	Information not provided
ANH	► Unable to provide the fixed asset table requested in the pre-site questions.
BRL	N/A
CAM	N/A
DVW	N/A
NES	N/A
NWT	N/A
PRT	N/A
SBW	N/A
SES	► Pre site question responses. ► The costs of internally generated calls allocated to retail in relation to 'network calls.'
SEW	N/A
SRN	N/A
SST	N/A
SVT	N/A
SWT	N/A
TMS	N/A
VCE	► Unable to provide the fixed asset table requested in the pre-site questions. ► The value of income and bad debt charge that relates to amounts billed to The Occupier in 2011/12. ► Costs allocated to retail in relation to 'network calls.'
VEA	► Unable to provide the fixed asset table requested in the pre-site questions. ► Unable to provide the G&S expenditure table requested in the pre-site questions. ► The treatment of billed unpaid amounts when a customer vacates a premises. ► Costs allocated to retail in relation to 'network calls.' ► The number of FTE in the water business unit and the retail business unit.
VSE	► No information in relation to VSE provided.
WSH	N/A
WSX	N/A
YKY	N/A

Appendix E Site visit agenda

1. Introduction.

2. Overview of how retail activities are separated from wholesale activities both functionally and administratively.

3. Overview of how Activity Costing Analysis tables are compiled (Key information sources, key calculations/allocations performed outside of your accounting system, etc.).

4. Overview of quality assurance and governance procedures relating to preparation of tables and methodology.

5. Overview of allocation of costs and assets, specifically how:

    a. Direct costs and operational expenditure (opex) are allocated:

        i Between wholesale and retail Services?

        ii For retail only, between retail household and retail non-household?

    b. General and support expenditure is allocated between wholesale and retail services.

    c. Other operating expenditure is allocated between wholesale and retail Services.

    d. Assets are allocated to retail services and then between retail household and retail non-household.

6. Revenue

    a. Overview of revenue recognition policy.

    b. Treatment of unoccupied properties.

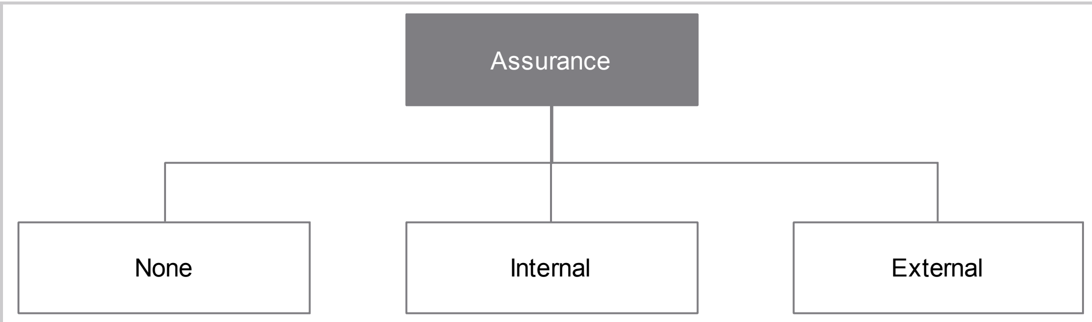
    c. Treatment of bad debts.

7. Any other business.

Appendix F Categories of recommendations

Assurance

Recommendations in relation to assurance concern an expression of opinion being given over the reported accounting separation information. The diagram below shows the range of sources of assurance that could be used to provide an opinion over the reported accounting separation data.



Having determined the source of assurance consideration needs to be given as to what the expression of opinion is to be given over. In simple terms these relate to:

- **Basis of preparation:** The reported accounting separation data has been prepared in a particular way, for example in accordance with the company's Methodology Statement and/or the regulatory accounting guidelines.
- **Accuracy of content:** The reported accounting separation data presents an accurate picture of the costs incurred in the company's retail operations.

In considering 'accuracy of content' expression of opinion then there are a number of possible options that could be used, as follows:

- **Agreed scope procedures:** Certain specified procedures are performed the results of which (including exceptions) are reported.
- **Confidence grades:** Ratings are applied to the reliability and accuracy of reported information (as used to be the case with the June Return tables).
- **'Audit' style opinion:** The reported data shows a 'true and fair view' or 'fairly presents' the reported data (the costs incurred by companies in their retail operations by reference to the relevant guidelines).

Within this report we have identified the following potential recommendations to the issues that we have identified:

	Basis of preparation	Accuracy of content		
Source of assurance	**Prepared in accordance with methodology**	**Agreed scope procedures**	**Confidence grading applied to reliability and accuracy**	**Fairly presents the costs of the company's retail operations**
Internal	√			√
External	√	√		√

Although we present confidence grading as an option we have not considered it further at this stage as it would require the derivation of ratings bands which may not be meaningful to the user. As the data is financial in nature we consider that an overall audit style opinion, if appropriate, would be better understood.

Benefits and drawbacks

Source of assurance

Third party assurance (e.g., an independent auditor or reporter) over reported data generally increases the confidence of the user over its robustness.

However, we note that there are situations when a statement of opinion from the company's directors has been used to increase assurance over data (for example Sarbanes-Oxley required companies to attest the processes that impact on the accuracy of financial information).

There is an obvious cost implication for companies if they are required to engage a third party to provide assurance over and above that which is given over the regulatory accounts as a whole.

Expression of opinion

Providing an opinion over the accuracy of content of information provides a more robust outcome than the basis of preparation but will be more onerous in terms of the procedures that are required and, if the assurance is to be given by a third party, the cost which is involved.

We understand that the accounting separation tables are to be brought into the scope of the regulatory accounts and will therefore be subject to the opinion that is given by the company's auditors. We note however that the opinion that will be given relates to the regulatory accounts as a whole and as such the materiality that is likely to be applied would be greater than would be applied were retail operations to be a standalone entity.

We note that should the companies' Methodology Statements be included within the regulatory accounts and be subject to the overall opinion we would expect that the auditors would review it to determine whether it was consistent with the way the data had been compiled such as would be the case with a Directors' report in a set of financial statements.

Where applicable

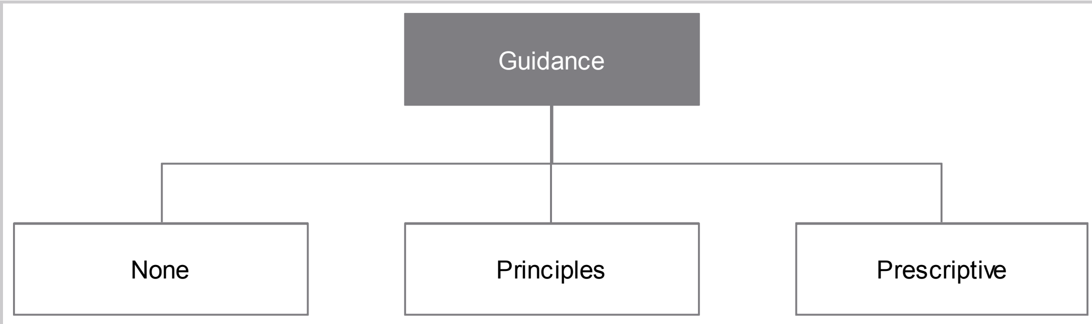
In section 5 of this report we set out our findings in relation to the robustness of reported accounting separation data with regard to companies' retail operations. In making a recommendation to address our findings we consider the following factors:

- The extent to which the matters we have identified result from the companies' methodology not providing appropriate guidance or where there is evidence to show reported methodologies are not being followed. In this case we would recommend assurance be given over the basis of preparation. We note that this recommendation will be linked to the transparency of the published methodology.
- The extent to which the matters we have identified have resulted (or have the potential to result in) significant errors in the identification and calculation of costs that are attributable to companies retail operations. If this is the case we would recommend third party assurance over the reported data as a whole.
- Whether the matter we have identified is linked to a particular activity or cost type or whether it affects the reported data as a whole. In the former case agreed upon procedures could be used either in isolation or alongside an overall audit style expression of opinion.
- The impact of the recommendation on the companies and users of the reported data.

We note that where a third party is to be engaged to provide an opinion over the reported data then its scope of work could be set by Ofwat and/or the companies and its terms of engagement agreed with Ofwat, the companies or on a tripartite basis.

Guidance

Recommendations in relation to guidance concern the degree to which the recognition, identification, allocation and reporting of costs in relation to companies' retail operations is prescribed in the Regulatory Accounting Guidelines. The diagram below shows the range of approaches to issuing guidance that can be applied to the reported accounting separation data:



In general the current approach to accounting separation is principles based, that is companies generally have discretion in the methodology that they use to derive and report their accounting separation data to achieve the desired result. A prescriptive approach removes the discretion given to the companies and mandates the way in which a particular issue is to be dealt with in the reported data.

Within this report we have identified potential recommendations where we believe more prescriptive guidance should be given to address inconsistencies in reported data.

Under the heading of guidance we also consider matters where our findings have identified differences in the companies interpretation of the current accounting separation guidance in the inclusion or exclusion of certain costs or activities in their retail operations.

Benefits and drawbacks

In general we consider that a principles based approach accompanied by more prescriptive guidance is most appropriate. Such an approach is consistent with that adopted in financial reporting where a principles based framework is supplemented by specific more prescriptive requirements targeted at particular issues. Those issues tend to be those where there is uncertainty or where significant judgements are applied which mean that what is essentially the same information can be reported in different ways.

We note that whilst there are differences in the way in which companies have structured their retail operations and demographic differences in the areas they serve the fundamental underlying businesses are the same. Therefore we consider that prescriptive guidance may be an appropriate recommendation to inconsistencies identified from the targeted review.

The benefits of more prescriptive guidance are:

- ► Reducing inconsistencies in the way in which data is reported, i.e., companies report the financial impact of the same transaction in the same way.
- ► Reduction in uncertainty of treatment where it appears that inconsistencies have arisen from differing interpretations of the accounting separation guidance.

The drawbacks associated with more prescriptive guidance are:

- ► Whether the requirement is achievable given a company's system constraints, e.g., the stipulation of a particular measure to use to allocate costs.
- ► The possibility that being too prescriptive means that the circumstances of each company is not taken into account which results in reported data being consistent but not reflecting the actual costs incurred in companies retail operations.
- ► Time and cost required.
- ► Greater reconciliation being required between statutory and regulatory accounts resulting in increased volume of reported information and confusion to users.

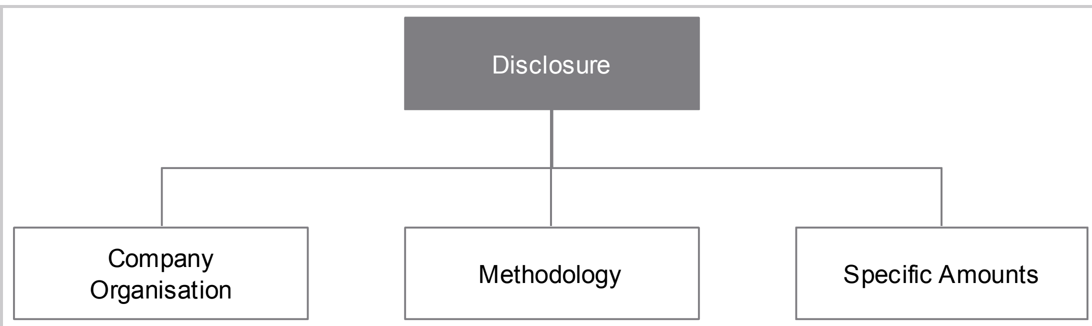
Where applicable

In section 6 of this report we set out our findings in relation to the comparability of reported accounting separation data with regard to companies' retail operations. In making a recommendation to address our findings we consider the following factors:

- ► The extent to which matters we have identified result from differing interpretation of Ofwat's guidance. Where this is the case we would recommend clarification of the relevant guidance.
- ► Inconsistencies arising from different approaches to recognising and reporting costs relating to what is, in substance, the same transaction. Where this is the case our recommendation will comprise additional guidance and/or disclosure (see below) depending on the significance of the impact of the inconsistency.
- ► Whether the inconsistency results from underlying business or environmental factors (i.e., the reported data presents a representative figure in relation to a company's retail costs) in which case our recommendation will also comprise additional guidance and/or disclosure (see below) depending on the significance of the impact of the inconsistency.

Disclosure

Recommendations in relation to disclosure concern the degree to which the provision of additional information to the user would improve their ability to make informed comparisons between companies and judgments based on the reported data. The diagram below shows a range of possible disclosures that could be made with regard to accounting separation data:



Considering each of these further:

- ► Company organisation: Disclosure comprising the way in which a company's retail activities are organised, e.g., in-house, outsourcing, joint venture, etc.
- ► Methodology: Detailed description of the basis on which the company's accounting separation reported data has been compiled.

- Specific amounts: Further disclosure in relation to specific amounts or balances including potential disaggregation of reported data into certain specified components or the alternative presentation of data using specific assumptions, e.g., actual costs are £X, applying Y basis would result in actual costs being £Z.

Benefits and drawbacks

The benefits of additional disclosure are that is provides the user with:

- Additional information to understand the way in which the information has been compiled.
- Insight into particular amounts or balances.
- Greater ability to make informed comparisons or judgments.

Drawbacks associated with additional disclosure are:

- The danger of revealing commercially sensitive information.
- Time and cost required.
- The level of information provided to the user is disproportionate and therefore detracts from its intended purpose.

Where applicable?

In section 7 of this report we set out our findings in relation to the transparency of reported account separation data with regard to companies' retail operations. In making a recommendation to address our findings we consider the following factors:

- Whether it is necessary to provide the user with an understanding of the substance of a transaction by explaining the basis on which it has been recorded and reported.
- Whether providing additional understanding is necessary to allow the user to make comparisons between companies.
- Where it is necessary to address a perception that the data is not comparable. The information that has been reported is consistent between companies and/or accurately reflects the costs incurred in providing the retail service but there is a perception to the contrary that additional disclosure would resolve.

Impact on previously reported information

The recommendations that are proposed within this report are intended to improve the robustness, comparability and transparency of future reported accounting separation data.

In making recommendations we have also considered the impact on previously reported data. There are three instances that we have identified which we consider have the potential impact on previously reported data, namely:

- Errors and omissions in previously reported data.
- Uncertainty over previously reported data.
- The impact of future changes affecting year on year comparisons.

Errors and omissions in previously reported data

As set out in section 6.1 our targeted review has been performed upon the data reported in relation to 2011/12. As set out in section 6 of this report we have identified certain errors and omissions in this data.

Consistent with financial reporting guidance we would only propose a restatement to prior years reported data if we considered the error to be fundamental with a material impact.

Uncertainty over previously reported data

Where we have as part of our review asked companies to provide additional data and analysis underlying data reported in relation to 2011/12 and that information is not capable of being provided we have considered the extent to which there is an implication for the robustness of the prior reported information and whether as a result we consider it should be restated.

Year on year comparison

Implementation of the proposed recommendations in this report may mean that the basis of preparation of particular balances or amounts changes from previously reported information.

Consistent with financial reporting guidance we would only propose a restatement of prior years reported data if we considered the change to have a material impact.

For those items where our recommendation covers further disclosure or the disaggregation of particular balances or amounts then we consider whether it would be beneficial to the user of the data to retrospectively provide further disclosure or disaggregation to enable year on year comparisons to be drawn. In this case the previously reported data is unchanged but further analysis is provided as part of the data reported for the current year to include the impact on prior periods.

Appendix G CTS and ACTS

Refer to separate PDF document.

Appendix H CTS – core customer services activities

Row number			1	2	3	7	8	
Company	**Company type**	**Unique customers 000s**	**Billing (£)**	**Payment handling, remittance and cash handling (£)**	**Debt management (£)**	**Non-network customer enquiries and complaints (£)**	**Meter reading (£)**	**Total 'Customer Services' (£)**
ANH	WaSC	2,681.43	1.23	0.40	3.41	1.40	1.26	**7.70**
WSH	WaSC	1,344.62	1.54	0.72	4.09	2.76	1.38	**10.49**
NES	WaSC	1,828.55	2.52	0.44	1.75	2.24	1.09	**8.04**
SVT	WaSC	4,035.52	1.64	0.57	2.25	1.93	1.19	**7.58**
SWT	WaSC	705.02	1.70	1.42	0.99	3.40	1.99	**9.50**
SRN	WaSC	1,805.08	2.22	0.66	3.05	2.77	1.99	**10.69**
TMS	WaSC	5,210.60	2.49	1.13	2.92	1.77	0.96	**9.27**
NWT	WaSC	2,896.97	3.42	0.21	4.11	4.31	2.07	**14.12**
WSX	WaSC	1,112.17	2.16	0.63	2.34	1.62	1.44	**8.18**
YKY	WaSC	2,087.05	1.17	0.77	1.44	5.08	0.75	**9.22**
AFW	WOC	1,322.01	1.82	0.26	0.99	2.51	1.91	**7.49**
BRL	WOC	465.90	1.26	0.36	1.31	1.05	0.80	**4.78**
CAM/SST	WOC	639.55	1.33	1.98	1.82	2.97	1.24	**9.34**
DVW	WOC	111.09	1.58	2.09	1.87	0.62	1.55	**7.71**
PRT	WOC	279.67	0.93	0.40	0.86	0.93	0.48	**3.60**
SBW	WOC	183.90	0.96	1.47	2.12	0.08	0.98	**5.61**
SEW	WOC	804.38	1.51	0.29	1.76	3.18	1.40	**8.14**
SES	WOC	257.89	2.54	3.29	2.65	1.41	0.74	**10.62**
		27,771.40						
Weighted average			**2.01**	**0.71**	**2.59**	**2.51**	**1.32**	**9.14**
			22.0%	**7.7%**	**28.3%**	**27.5%**	**14.5%**	

Appendix I Household and non-household drivers

Refer to separate PDF document.

Appendix J G&S CTS

Company	Company Type	Unique customers 000s	G&S CTS (£)	Customer services department
ANH	WaSC	2,681.43	2.82	Some activities outsourced to India
WSH	WaSC	1,344.62	7.79	Third party
NES	WaSC	1,828.55	4.05	In house
SVT	WaSC	4,035.52	2.78	Some activities outsourced to India
SWT	WaSC	705.02	3.97	Third party/Associated company within group
SRN	WaSC	1,805.08	3.77	In house
TMS	WaSC	5,210.60	1.46	Some activities outsourced to India
NWT	WaSC	2,896.97	3.31	In house
WSX	WaSC	1,112.17	0.36	Joint Venture with BRL
YKY	WaSC	2,087.05	2.04	Associated company within group
AFW	WOC	1,322.01	5.44	In house
BRL	WOC	465.90	1.85	Joint Venture with WSX
CAM/SST	WOC	639.55	4.24	In house/Associated company within group
DVW	WOC	111.09	6.77	In house
PRT	WOC	279.67	6.23	In house
SBW	WOC	183.90	4.40	In house
SEW	WOC	804.38	4.31	In house
SES	WOC	257.89	3.56	In house
		27,771.40		
Weighted average			**3.12**	

Appendix K Doubtful debt relating to The Occupier

A	B	C	D	E	F	G	H	I	J	K
Company	Company type	Unique customers	Total retail doubtful debt cost	Bad debt in relation to The Occupier	Revised retail doubtful debt cost	Household %*	Revised household cost	Revised CTS	Original CTS	Difference
					D-E		F*G	H/C*1000		I-J
		000s	£m	£m	£m	%	£m	£	£	£
ANH	WaSC	2,681.43	33.886	-	33.886	87.7%	29.714	11.08	11.08	–
WSH	WaSC	1,344.62	26.953		26.953	71.9%	19.371	14.41	14.41	–
NES	WaSC	1,828.55	18.400	-	18.400	92.9%	17.100	9.35	9.35	–
SVT	WaSC	4,035.52	31.200	0.000	31.200	85.6%	26.700	6.62	6.62	–
SWT	WaSC	705.02	14.700	-	14.700	98.0%	14.400	20.42	20.42	–
SRN	WaSC	1,805.08	26.800	-	26.800	98.9%	26.500	14.68	14.68	–
TMS	WaSC	5,210.60	70.600		70.600	85.8%	60.600	11.63	11.63	–
NWT	WaSC	2,896.97	67.500	0.400	67.100	93.5%	62.726	21.65	21.78	(0.13)
WSX	WaSC	1,112.17	10.100		10.100	90.1%	9.100	8.18	8.18	–
YKY	WaSC	2,087.05	15.276	-	15.276	86.4%	13.191	6.32	6.32	–
AFW	WOC	1,322.01	6.629		6.629	84.4%	5.598	4.23	4.23	–
BRL	WOC	465.90	2.500	-	2.500	75.8%	1.896	4.07	4.07	–
CAM/SST	WOC	639.55	2.756		2.756	84.4%	2.326	3.64	3.64	–
DVW	WOC	111.09	0.440		0.440	89.5%	0.394	3.55	3.55	–
PRT	WOC	279.67	0.535		0.535	96.4%	0.516	1.85	1.85	–
SBW	WOC	183.90	0.356	0.006	0.350	78.9%	0.276	1.50	1.53	(0.03)
SEW	WOC	804.38	3.455	-	3.455	90.1%	3.114	3.87	3.87	–
SES	WOC	257.89	0.340	-	0.340	80.9%	0.275	1.07	1.07	–
		27,771.40								
Weighted average								**10.58**	**10.59**	

Key	
*	Calculated using household data from table 2 row 4
(green)	Value unknown/data not available
(blue)	Information not provided

Appendix L Interpretational differences – Network customer enquiries and complaints

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q
Company	Company type	Unique customers	Total Network customer enquiries and complaints cost	Cost of schedulers/ investigatory work/ internally generated calls	Revised Total Network customer enquiries and complaints cost	House-hold %*	Revised house-hold cost	Retail CTS	schedulers/ investigatory work/ internally generated calls CTS	Revised retail CTS	Household %*	Revised household CTS	Original CTS	Difference	Adjustment to include schedulers, investigatory work and internally generated calls for all companies**	Revised CTS
					D-E		F*G	D/C*1000	E/C*1000	F/C*1000		K*L		N-M		N+P
		000s	£m	£m	£m	%	£m	£	£	£	%	£	£	£	£	£
ANH	WaSC	2,681.43	1.116	-	1.116	91.9%	1.026	0.42	-	0.42	91.9%	0.38	0.38	0.00	0.44	0.82
WSH	WaSC	1,344.62	2.360	-	2.360	85.9%	2.027	1.76	-	1.76	85.9%	1.51	1.51	0.00	0.44	1.95
NES	WaSC	1,828.55	0.900		0.900	88.9%	0.800	0.49	-	0.49	88.9%	0.44	0.44	0.00	0.44	0.88
SVT	WaSC	4,035.52	6.300	2.621	3.679	93.7%	3.445	1.56	0.65	0.91	93.7%	0.85	1.46	(0.61)	–	1.46
SWT	WaSC	705.02	1.400	0.515	0.885	92.9%	0.822	1.99	0.73	1.26	92.9%	1.17	1.84	(0.68)	–	1.84
SRN	WaSC	1,805.08	0.600	-	0.600	100.0%	0.600	0.33	-	0.33	100.0%	0.33	0.33	0.00	0.44	0.77
TMS	WaSC	5,210.60	5.000	-	5.000	84.0%	4.200	0.96	-	0.96	84.0%	0.81	0.81	0.00	0.44	1.25
NWT	WaSC	2,896.97	4.600	0.682	3.918	93.5%	3.662	1.59	0.24	1.35	93.5%	1.26	1.48	(0.22)	–	1.48
WSX	WaSC	1,112.17	1.400	0.600	0.800	92.9%	0.743	1.26	0.54	0.72	92.9%	0.67	1.17	(0.50)	–	1.17
YKY	WaSC	2,087.05	5.424	1.280	4.144	93.1%	3.859	2.60	0.61	1.99	93.1%	1.85	2.42	(0.57)	–	2.42
AFW	WOC	1,322.01	0.432	-	0.432	94.7%	0.409	0.33	-	0.33	94.7%	0.31	0.31	0.00	0.44	0.75
BRL	WOC	465.90	1.255	0.841	0.414	93.7%	0.388	2.69	1.81	0.89	93.7%	0.83	2.52	(1.69)	–	2.52
CAM/SST	WOC	639.55	0.375	0.158	0.217	94.1%	0.204	0.59	0.25	0.34	94.1%	0.32	0.55	(0.23)	–	0.55
DVW	WOC	111.09	0.210	0.169	0.041	95.2%	0.039	1.89	1.52	0.37	95.2%	0.35	1.80	(1.45)	–	1.80
PRT	WOC	279.67	0.245	-	0.245	93.5%	0.229	0.88	-	0.88	93.5%	0.82	0.82	0.00	0.44	1.26
SBW	WOC	183.90	0.069	-	0.069	91.3%	0.063	0.38	-	0.38	91.3%	0.34	0.34	0.00	0.44	0.78
SEW	WOC	804.38	1.962	0.525	1.437	91.6%	1.317	2.44	0.65	1.79	91.6%	1.64	2.24	(0.60)	–	2.24
SES	WOC	257.89	0.408	0.191	0.217	89.2%	0.194	1.58	0.74	0.84	89.2%	0.75	1.41	(0.66)	–	1.41
		27,771.40	**34.056**	**7.582**	**26.470**		**24.027**									
Weighted average												**0.87**	**1.12**			**1.35**

Key

*	Calculated using household data from table 2 row 4
**	*Weighted average cost of schedulers, investigatory work and internally generated calls for companies that include these costs has been applied to companies who do not include these costs within retail
(grey)	Information not provided
(yellow)	Company confirmed amount unknown/can not be identified
(green)	Cost part quantified/part confirmed to be unknown
(blue)	Cost part quantified/part not provided

Appendix M Interpretational differences – G&S

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
		Current			Re modeling									
Company	Company Type	Company total G&S	Retail G&S	Retail G&S %	Vehicles	Stores	Direct costs	Employment	Mechanical & Electrical	Technical support	Regulation	Revised company total G&S	Revised retail G&S %	Difference
				D/C								C-sum(F:L)	D/M	N-E
		£m	£m	%	£m	£m	£m	£m	£m	£m	£m	£m	%	%
ANH	WaSC	58.412	8.977	15.4%	–	–	–	–	-	–	1.966	56.446	15.9%	0.5%
NES	WaSC	40.000	8.400	21.0%	–	–	–	–	–	–	–	40.000	21.0%	0.0%
NWT	WaSC	98.700	11.900	12.1%	–	–	54.646	–	–	–	–	44.054	27.0%	15.0%
SRN	WaSC	23.700	7.200	30.4%	–	–	–	–	–	–	–	23.700	30.4%	0.0%
SVT	WaSC	64.300	12.600	19.6%	(6.883)	–	–	–	–	–	–	71.183	17.7%	(1.9)%
SWT	WaSC	15.300	3.400	22.2%	–	–	–	–	–	–	–	15.300	22.2%	0.0%
TMS	WaSC	101.500	9.600	9.5%	7.600	–	26.800	–	–	–	–	67.100	14.3%	4.8%
WSH	WaSC	47.290	11.670	24.7%	–	–	3.750	–	–	–	–	43.540	26.8%	2.1%
WSX	WaSC	9.600	0.700	7.3%	–	–	0.801	–	–	–	–	8.799	8.0%	0.7%
YKY	WaSC	29.249	5.411	18.5%	–	–	–	–	–	–	–	29.249	18.5%	0.0%
AFW	WOC	26.349	7.568	28.7%	–	–	1.900	–	–	–	–	24.449	31.0%	2.2%
BRL	WOC	9.596	0.941	9.8%	–	–	–	–	–	–	–	9.596	9.8%	0.0%
CAM/SST	WOC	11.377	3.128	27.5%	(0.532)	0.073	–	–	–	–	–	11.836	26.4%	(1.1)%
DVW	WOC	3.026	0.884	29.2%	–	–	–	–	–	–	–	3.026	29.2%	0.0%
PRT	WOC	7.246	1.864	25.7%	0.360	0.409	–	–	0.937	0.331	–	5.209	35.8%	10.1%
SBW	WOC	4.507	1.045	23.2%	0.052	–	0.423	–	–	–	–	4.032	25.9%	2.7%
SES	WOC	3.351	1.010	30.1%	–	–	–	0.051	–	–	–	3.300	30.6%	0.5%
SEW	WOC	9.459	3.962	41.9%	–	–	–	–	–	–	–	9.459	41.9%	0.0%

Key

(shaded)	Costs includes a retail element

Appendix N [Redacted]

Appendix O G&S CTS – Omissions

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
			Current				Re modelling								
Company	Company type	Unique customers	Company total G&S	Retail G&S	Household G&S	Household G&S as % of retail	Insurance	Premises /facilities	Management/ professional fees	Costs over allocated	Revised retail G&S	Revised household G&S	Revised CTS (G&S)	CTS (G&S)	Difference
											E+sum(H:K)	G*L	M/C*1000		N-O
		000s	£m	£m	£m	%	£m	£m	£m	£m	£m	£m	£	£	£
ANH	WaSC	2,681.43	58.412	8.977	7.571	84.3%	-	-	-	-	8.977	7.571	2.82	2.82	-
WSH	WaSC	1,344.62	47.290	11.670	10.469	89.7%	-	-	-	-	11.670	10.469	7.79	7.79	-
NES	WaSC	1,828.55	40.000	8.400	7.400	88.1%	-	-	-	-	8.400	7.400	4.05	4.05	-
SVT	WaSC	4,035.52	64.300	12.600	11.200	88.9%	-	-	-	-	12.600	11.200	2.78	2.78	-
SWT	WaSC	705.02	15.300	3.400	2.800	82.4%	-	-	-	-	3.400	2.800	3.97	3.97	-
SRN	WaSC	1,805.08	23.700	7.200	6.800	94.4%	-	-	-	(0.384)	6.816	6.437	3.57	3.77	(0.20)
TMS	WaSC	5,210.60	101.500	9.600	7.600	79.2%	-	-	-	-	9.600	7.600	1.46	1.46	-
NWT	WaSC	2,896.97	98.700	11.900	9.600	80.7%	-	-	-	-	11.900	9.600	3.31	3.31	-
WSX	WaSC	1,112.17	9.600	0.700	0.400	57.1%	-	-	-	-	0.700	0.400	0.36	0.36	-
YKY	WaSC	2,087.05	29.249	5.411	4.261	78.7%	-	0.300	-	-	5.711	4.497	2.15	2.04	0.11
AFW	WOC	1,322.01	26.349	7.568	7.186	95.0%	-	-	-	-	7.568	7.186	5.44	5.44	-
BRL	WOC	465.90	9.596	0.941	0.864	91.8%	0.053	0.008	-	-	1.002	0.920	1.97	1.85	0.12
CAM/SST	WOC	639.55	11.377	3.128	2.712	86.7%	-	-	-	-	3.128	2.712	4.24	4.24	-
DVW	WOC	111.09	3.026	0.884	0.752	85.1%	-	-	-	-	0.884	0.752	6.77	6.77	-
PRT	WOC	279.67	7.246	1.864	1.741	93.4%	-	0.043	-	-	1.907	1.781	6.37	6.23	0.14
SBW	WOC	183.90	4.507	1.045	0.809	77.4%	-	-	-	-	1.045	0.809	4.40	4.40	-
SEW	WOC	804.38	9.459	3.962	3.469	87.6%	-	-	-	-	3.962	3.469	4.31	4.31	-
SES	WOC	257.89	3.351	1.010	0.918	90.9%	-	-	-	-	1.01	0.92	3.56	3.56	-
		27,771.40													
Weighted average													**3.12**	**3.12**	

Key

	Costs omitted from G&S (amount not quantified by company)

Appendix P [Redacted]

Appendix Q G&S CTS restated using various drivers

Company	Company type	Unique customers	G&S CTS	G&S CTS allocated based on: Direct costs*	Direct costs* excluding doubtful debt	Employment costs	FTE
		000s	£	£	£	£	£
ANH	WaSC	2,681.43	2.82	4.30	2.40	4.23	3.46
WSH	WaSC	1,344.62	7.79	8.33	4.04	2.22	1.80
NES	WaSC	1,828.55	4.05	4.31	2.61	5.31	4.57
SVT	WaSC	4,035.52	2.78	2.87	1.91	3.95	4.73
SWT	WaSC	705.02	3.97	4.70	2.84	3.30	6.60
SRN	WaSC	1,805.08	3.77	3.82	2.34	3.97	3.91
TMS	WaSC	5,210.60	1.46	4.39	2.54	2.64	1.50
NWT	WaSC	2,896.97	3.31	10.61	6.32	9.83	9.47
WSX	WaSC	1,112.17	0.36	1.43	1.01	1.79	0.88
YKY	WaSC	2,087.05	2.04	2.32	1.78	1.76	1.47
AFW	WOC	1,322.01	5.44	4.97	3.81	6.55	-
BRL	WOC	465.90	1.85	4.17	2.89	2.67	2.31
CAM/SST	WOC	639.55	4.24	4.41	3.52	4.55	6.67
DVW	WOC	111.09	6.77	6.26	5.06	4.78	8.68
PRT	WOC	279.67	6.23	5.27	4.14	9.76	7.20
SBW	WOC	183.90	4.40	3.30	2.70	8.63	7.13
SEW	WOC	804.38	4.31	2.63	2.13	5.57	5.66
SES	WOC	257.886	3.56	2.74	2.57	3.64	2.53
		27,771.40					
Weighted average			**3.12**	**4.66**	**2.89**	**4.34**	**3.78**

Key

*	Including reallocations of costs where the current intention is that the costs will be reclassified as wholesale
(yellow)	Information not provided

Appendix R G&S expenditure table

Category of G&S expenditure	Overview of different types of costs included within this category	Proportion of category a. Directly attributed to (wholesale and retail) before allocation, and b. Allocated	Specific cost driver used to allocate costs between retail and wholesale	Total value of category (A)	Proportion allocated to Wholesale (%)	Proportion allocated to retail (B) (%)	Specific cost driver used to allocate between household/ non-household	Proportion allocated to household	Proportion allocated to non-household
HR		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Finance		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Information Systems		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Insurance		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Facilities		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Shared premises costs		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Shared directors remuneration		[x]% directly attributed, [x]% allocated		-	[x]% of A	[x]% of A		[x]% of B	[x]% of B
Other		[x]% directly attributed, [x]% allocated			[x]% of A	[x]% of A		[x]% of B	[x]% of B
Total per retail Table (£)				**£0.00m**	**£0.00m**	**£0.00m**		**£0.00m**	**£0.00m**

Appendix S Scientific services CTS

			Adjustment calculation*			Scientific services CTS		
Company	**Company type**	**Unique customers**	**Unique customers**	**Revised ACTS**	**Original ACTS**	**Adjustment***	**Revised**	**Difference**
		000s	**000s**	**£**	**£**	**£**	**£**	**£**
ANH	WaSC	2,681.43		-	-	0.44	0.44	
WSH	WaSC	1,344.62		-	-	0.44	0.44	
NES	WaSC	1,828.55	1,828.55	0.82	0.82	-	0.82	
SVT	WaSC	4,035.52		-	-	0.44	0.44	
SWT	WaSC	705.02		-	-	0.44	0.44	
SRN	WaSC	1,805.08	1,805.08	0.11	0.11	-	0.11	
TMS	WaSC	5,210.60		-	-	0.44	0.44	
NWT	WaSC	2,896.97		-	-	0.44	0.44	
WSX	WaSC	1,112.17	1,112.17	0.45	0.45	-	0.45	
YKY	WaSC	2,087.05		-	-	0.44	0.44	
AFW	WOC	1,322.01	1,322.01	0.22	0.22	-	0.22	
BRL	WOC	465.90	465.90	0.37	0.37	-	0.37	
CAM/SST	WOC	639.55	639.55	0.42	0.42	-	0.42	
DVW	WOC	111.09	111.09	0.27	0.27	-	0.27	
PRT	WOC	279.67	279.67	0.20	0.20	-	0.20	
SBW	WOC	183.90	183.90	0.05	0.05	-	0.05	
SEW	WOC	804.38	804.38	0.93	0.93	-	0.93	
SES	WOC	257.89		-	-	0.44	0.44	
		27,771.40	**8,552.30**					
Weighted average				**0.44**	**0.14**		**0.44**	**0.31**

*Weighted average cost of scientific services of companies that include scientific services has been applied to companies who do not include scientific services within retail.

Appendix T Other business activities CTS

Company	Company type	Unique customers	Other business activities CTS Original	Adjustment	Revised	Difference ACTS
		000s	£	£	£	£
ANH	WaSC	2,681.43	-	0.10	0.10	
WSH	WaSC	1,344.62	0.14	-	0.14	
NES	WaSC	1,828.55	0.05	-	0.05	
SVT	WaSC	4,035.52	0.12	-	0.12	
SWT	WaSC	705.02	0.14	-	0.14	
SRN	WaSC	1,805.08	0.39	-	0.39	
TMS	WaSC	5,210.60	-	-	-	
NWT	WaSC	2,896.97	0.45	-	0.45	
WSX	WaSC	1,112.17	0.27	-	0.27	
YKY	WaSC	2,087.05	0.10	-	0.10	
AFW	WOC	1,322.01	0.10	-	0.10	
BRL	WOC	465.90	0.24	-	0.24	
CAM/SST	WOC	639.55	0.33	-	0.33	
DVW	WOC	111.09	0.32	-	0.32	
PRT	WOC	279.67	0.19	-	0.19	
SBW	WOC	183.90	0.14	-	0.14	
SEW	WOC	804.38	0.62	-	0.62	
SES	WOC	257.886	0.23	-	0.23	
		27,771.40				
Weighted average			**0.16**		**0.17**	**0.01**

Key

(teal)	Amount that should have been included provided by company, multiplied by the household percentage for total direct costs
(red)	Other business activities included within G&S expenditure, therefore no impact on CTS or ACTS

Appendix U Depreciation charge CTS analysis

					Retail household				CTS							
Company	Company type	Unique customers	Adjusted CC depreciation excl metering	Adjusted CC depreciation excl metering CTS	Billing system	Directly allocated (exc Billing system & meters)	Allocation of shared assets	Total	Billing system		Directly allocated (exc Billing system & meters)		Allocation of shared assets		Balance*	
		000s	£m	£	£m	£m	£m	£m	£	%	£	%	£	%	£	%
ANH	WaSC	2,681.43	10.314	3.85	6.099			6.099	2.27	59.1%	-	0.0%	-	0.0%	1.57	40.9%
WSH	WaSC	1,344.62	0.000	-	-	0.400	-	0.400	-	N/A	0.30	N/A	-	N/A	(0.30)	N/A
NES	WaSC	1,828.55	11.300	6.18	0.892	0.178	2.497	3.568	0.49	7.9%	0.10	1.6%	1.37	22.1%	4.23	68.4%
SVT	WaSC	4,035.52	17.393	4.31	6.072	2.628	7.975	16.675	1.50	34.9%	0.65	15.1%	1.98	45.9%	0.18	4.1%
SWT	WaSC	705.02	2.605	3.69	1.165	0.535	0.800	2.500	1.65	44.7%	0.76	20.6%	1.13	30.7%	0.15	4.0%
SRN	WaSC	1,805.08	14.439	8.00	9.300	2.300	2.800	14.400	5.15	64.4%	1.27	15.9%	1.55	19.4%	0.02	0.3%
TMS	WaSC	5,210.60	3.053	0.59	-	1.656	1.325	2.981	-	0.0%	0.32	54.2%	0.25	43.4%	0.01	2.4%
NWT	WaSC	2,896.97	12.763	4.41	7.317	3.223	2.178	12.718	2.53	57.3%	1.11	25.3%	0.75	17.1%	0.02	0.4%
WSX	WaSC	1,112.17	2.100	1.89	1.388	0.394	0.150	1.932	1.25	66.1%	0.35	18.8%	0.13	7.1%	0.15	8.0%
YKY	WaSC	2,087.05	7.956	3.81	1.400	3.000	1.800	6.200	0.67	17.6%	1.44	37.7%	0.86	22.6%	0.84	22.1%
AFW	WOC	1,322.01	0.000	-				-	-	N/A	-	N/A	-	N/A	-	N/A
BRL	WOC	465.90	0.614	1.32	0.100	0.300	0.300	0.700	0.21	16.3%	0.64	48.9%	0.64	48.9%	(0.18)	(14.0)%
CAM/SST	WOC	639.55	1.964	3.07	0.320	0.066	0.793	1.178	0.50	16.3%	0.10	3.4%	1.24	40.4%	1.23	40.0%
DVW	WOC	111.09	0.202	1.82	0.002	0.018	0.247	0.267	0.02	1.0%	0.16	8.9%	2.22	122.3%	(0.59)	(32.2)%
PRT	WOC	279.67	0.165	0.59	-	0.073	0.092	0.165	-	0.0%	0.26	44.2%	0.33	55.8%	-	0.0%
SBW	WOC	183.90	0.370	2.01	0.130	0.049	0.255	0.434	0.71	35.1%	0.27	13.2%	1.39	68.9%	(0.35)	(17.3)%
SEW	WOC	804.38	2.266	2.82	0.800	-	1.500	2.300	0.99	35.3%	-	0.0%	1.86	66.2%	(0.04)	(1.5)%
SES	WOC	257.886	0.202	0.78	0.041	-	0.141	0.182	0.16	20.3%	-	0.0%	0.55	69.8%	0.08	9.9%
		27,771.40	**87.71**													
Weighted average				**3.16**												

Key

(light green)	Household percentage based on total household depreciation as a percentage of total retail depreciation
(dark green)	Company confirmed they are unable to provide information
*	As set out in section 6.3.14, the CCD data in relation to meters (ST7) is unreliable, this has led to a difference between the model and the responses to the pre site questions

Appendix V Depreciation charge CTS – treatment of billing system

			Household depreciation					
Company	Company type	Unique customers	Billing system	Adjustment to allocate 100% to retail	Revised billing system	Original billing system CTS	Revised billing system CTS	Difference
		000s	£m	£m	£m	£	£	£
ANH	WaSC	2,681.43	6.099	-	6.099	2.27	2.27	-
WSH	WaSC	1,344.62	-	-	-	-	-	-
NES	WaSC	1,828.55	0.892	0.357	1.249	0.49	0.68	0.20
SVT	WaSC	4,035.52	6.072	-	6.072	1.50	1.50	-
SWT	WaSC	705.02	1.165	-	1.165	1.65	1.65	-
SRN	WaSC	1,805.08	9.300	-	9.300	5.15	5.15	-
TMS	WaSC	5,210.60	-	-	-	-	-	-
NWT	WaSC	2,896.97	7.317	-	7.317	2.53	2.53	-
WSX	WaSC	1,112.17	1.388	-	1.388	1.25	1.25	-
YKY	WaSC	2,087.05	1.400	-	1.400	0.67	0.67	-
AFW	WOC	1,322.01		-	-	-	-	-
BRL	WOC	465.90	0.100	-	0.100	0.21	0.21	-
CAM/SST	WOC	639.55	0.320	-	0.320	0.50	0.50	-
DVW	WOC	111.09	0.002	-	0.002	0.02	0.02	-
PRT	WOC	279.67	-	-	-	-	-	-
SBW	WOC	183.90	0.130	-	0.130	0.71	0.71	-
SEW	WOC	804.38	0.800	-	0.800	0.99	0.99	-
SES	WOC	257.89	0.041	-	0.041	0.16	0.16	-
		27,771.40						
Weighted average						**1.26**	**1.27**	**0.01**

Key

	Company confirmed they are unable to provide information
	Household percentage based on household depreciation as a percentage of total retail depreciation

Appendix W Overall impact of inconsistency identified on ACTS

				Restatements – impact on CTS												
Company	Company type	Unique customers	Original CTS	Bad debt in relation to The Occupier	Interpretational differences – Network customer enquiries and complaints	G&S missing/ over allocated costs	Depreciation- Treatment of billing system	Scientific services missing costs	Other business activities missing costs	Credit notes issued when a customer vacates a premises	Revised CTS	Total difference	Revised CTS excluding network customer enquiries and complaints restatements	Adjustment to include activities within network customer enquiries and complaints	Revised CTS	Total difference
				Appendix K	Appendix L	Appendix O	Appendix V	Appendix S	Appendix T	Appendix AA				Appendix L		
		000s	£	£	£	£	£	£	£	£	£	£	£	£	£	£
ANH	WaSC	2,681.43	28.17	0.00	0.00	0.00	0.00	0.44	0.10	0.00	28.72	0.54	28.72	0.44	29.16	0.99
WSH	WaSC	1,344.62	35.01	0.00	0.00	0.00	0.00	0.44	0.00	0.00	35.45	0.44	35.45	0.44	35.89	0.88
NES	WaSC	1,828.55	31.34	0.00	0.00	0.00	0.20	0.00	0.00	0.00	31.53	0.20	31.53	0.44	31.97	0.64
SVT	WaSC	4,035.52	23.94	0.00	(0.61)	0.00	0.00	0.44	0.00	0.00	23.77	(0.17)	24.38	0.00	24.38	0.44
SWT	WaSC	705.02	43.41	0.00	(0.68)	0.00	0.00	0.44	0.00	0.00	43.17	(0.24)	43.85	0.00	43.85	0.44
SRN	WaSC	1,805.08	39.41	0.00	0.00	(0.20)	0.00	0.00	0.00	0.00	39.21	(0.20)	39.21	0.44	39.65	0.24
TMS	WaSC	5,210.60	23.69	0.00	0.00	0.00	0.00	0.44	0.00	0.00	24.14	0.44	24.14	0.44	24.58	0.88
NWT	WaSC	2,896.97	51.35	(0.13)	(0.22)	0.00	0.00	0.44	0.00	0.00	51.45	0.09	51.67	0.00	51.67	0.31
WSX	WaSC	1,112.17	23.11	0.00	(0.50)	0.00	0.00	0.00	0.00	0.00	22.61	(0.50)	23.11	0.00	23.11	0.00
YKY	WaSC	2,087.05	26.72	0.00	(0.57)	0.11	0.00	0.44	0.00	0.27	26.97	0.25	27.54	0.00	27.54	0.82
AFW	WOC	1,322.01	21.00	0.00	-	0.00	0.00	0.00	0.00	0.00	21.00	0.00	21.00	0.44	21.44	0.44
BRL	WOC	465.90	16.16	0.00	(1.69)	0.12	0.00	0.00	0.00	0.00	14.59	(1.57)	16.28	0.00	16.28	0.12
CAM/SST	WOC	639.55	22.64	0.00	(0.23)	0.00	0.00	0.00	0.00	0.00	22.41	(0.23)	22.64	0.00	22.64	0.00
DVW	WOC	111.09	23.23	0.00	(1.45)	0.00	0.00	0.00	0.00	0.00	21.78	(1.45)	23.23	0.00	23.23	0.00
PRT	WOC	279.67	13.81	0.00	0.00	0.14	0.00	0.00	0.00	0.00	13.95	0.14	13.95	0.44	14.39	0.59
SBW	WOC	183.90	14.76	(0.03)	0.00	0.00	0.00	0.00	0.00	0.00	14.73	(0.03)	14.73	0.44	15.17	0.42
SEW	WOC	804.38	22.34	0.00	(0.60)	0.00	0.00	0.00	0.00	0.00	21.74	(0.60)	22.34	0.00	22.34	0.00
SES	WOC	257.89	20.53	0.00	(0.66)	0.00	0.00	0.44	0.00	0.00	20.31	(0.22)	20.98	0.00	20.98	0.44
		27,771.40														
Weighted average			**29.31**								**29.39**		**29.65**		**29.88**	**0.57**

Key

(green)	Company confirmed value is unknown/data not available
(yellow)	Costs omitted from G&S (amount not quantified by company)
(blue)	Information not provided

Appendix X Disclosure within the Methodology Statement

Company	Approach to AS and processes undertaken	Underlying business structure	Drivers used to allocate costs between retail and wholesale	Drivers used to allocate costs between Household and non-household	Analytical review
ANH	Y	Y	Y	Y	Y
BRL	Y	Y	Y	Y	
CAM		Y	Y	Y	
DVW			Y	Y	
NES	Y		Y	Y	Y
NWT	Y				
PRT			Y	Y	
SBW	Y		Y	Y	
SES	Y		Y	Y	
SEW	Y	Y	Y	Y	Y
SRN	Y		Y	Y	
SST	Y		Y	Y	
SVT	Y		Y	Y	
SWT	Y		Y		
TMS	Y		Y	Y	
VCE	Y				
VEA	Y		Y		
VSE	Y		Y	Y	
WSH			Y	Y	
WSX	Y		Y	Y	
YKY			Y	Y	Y

Appendix Y Retail direct costs

Company	ANH	NES	NWT	SRN	SVT	SWT	TMS	WSH	WSX	YKY	BRL	CAM	DVW	PRT	SBW	SES	SEW	SST	VCE	VEA	VSE
Company type	WaSC	WaSC	WaSC	WaSC	WaSC	WaSC	WaSC	WaSC	WaSC	WaSC	WOC	WOC	WOC	WOC	WOC	WOC	WOC	WOC	WOC	WOC	WOC
Absolute amounts £m																					
Billing	3.998	5.100	11.700	5.000	7.400	1.400	15.300	2.233	2.700	3.693	0.674	0.217	0.191	0.296	0.193	0.693	1.317	0.685	1.988	0.338	0.227
Payment handling, remittance and cash handling	1.116	0.800	0.700	1.500	2.500	1.100	6.100	1.052	0.800	1.702	0.186	0.259	0.249	0.129	0.296	0.907	0.256	1.087	0.187	0.083	0.089
Debt management	10.469	3.900	14.800	5.900	10.900	0.700	16.900	5.765	2.800	3.859	0.666	0.256	0.281	0.283	0.491	0.761	1.570	1.169	1.116	0.128	0.340
Doubtful debts	33.886	18.400	67.500	26.800	31.200	14.700	70.600	26.953	10.100	15.276	2.500	0.200	0.440	0.535	0.356	0.340	3.455	2.556	5.485	0.473	0.671
Charitable trust donations	0.601	0.000	5.000	0.200	3.500	0.600	2.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.112	0.000	0.545	0.007	0.013
Vulnerable customer schemes	0.000	0.000	0.100	0.400	0.100	1.200	0.100	0.000	0.100	0.305	0.000	0.033	0.016	0.000	0.002	0.000	0.003	0.000	0.112	0.007	0.003
Non-network customer enquiries and complaints	4.575	4.600	14.600	5.300	8.300	2.700	10.500	4.051	2.200	11.438	0.551	0.494	0.075	0.279	0.015	0.391	2.805	1.526	3.109	0.240	0.148
Meter reading	3.664	2.300	8.100	4.100	5.600	1.600	7.300	2.026	1.800	1.849	0.449	0.181	0.180	0.177	0.197	0.215	1.326	0.766	2.647	0.161	0.084
Meter maintenance/installation non-capex	1.467	0.100	0.200	0.000	1.500	0.000	0.000	0.000	0.000	1.139	0.000	0.093	0.000	0.020	0.413	0.070	0.231	0.000	-0.003	0.083	0.026
Network customer enquiries and complaints	1.116	0.900	4.600	0.600	6.300	1.400	5.000	2.360	1.400	5.424	1.255	0.066	0.210	0.245	0.069	0.408	1.962	0.309	0.345	0.052	0.035
Disconnections	0.252	0.400	0.500	0.000	0.100	0.300	0.200	0.354	0.000	0.330	0.000	0.000	0.006	0.005	0.000	0.000	0.002	0.066	0.008	0.010	0.000
Demand-side water efficiency initiatives	3.094	1.500	0.800	0.100	0.800	0.300	2.700	0.000	0.200	0.437	0.273	0.022	0.031	0.086	0.006	0.133	0.215	0.000	0.335	0.006	0.013
Services to developers	0.246	0.000	0.000	4.200	0.100	4.500	0.300	0.669	2.500	6.977	0.087	(0.024)	0.062	0.036	0.004	0.024	(0.015)	0.023	0.000	0.000	0.000
Support for trade effluent compliance	0.873	0.100	1.700	0.400	1.600	0.300	0.800	0.080	0.100	0.422	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Customer-side leaks	3.222	2.600	0.800	1.400	3.400	0.500	2.700	0.000	2.300	2.259	0.114	0.101	0.062	0.002	0.000	0.199	0.453	0.565	0.866	0.013	0.043
Other direct costs	0.612	0.100	0.000	0.500	0.400	0.500	0.400	0.587	0.500	1.822	0.120	0.060	0.000	0.000	0.038	0.242	0.837	0.064	2.663	0.054	0.000
Total direct costs	**69.191**	**40.800**	**131.100**	**56.400**	**83.700**	**31.800**	**140.900**	**46.130**	**27.500**	**56.932**	**6.875**	**1.958**	**1.803**	**2.093**	**2.080**	**4.383**	**14.529**	**8.816**	**19.403**	**1.655**	**1.692**

Appendix Z [Redacted]

Appendix AA Credit notes issued when a customer vacates a premises

A	B	C	D	E	F	G	H	I	J	K
Company	Company type	Unique customers	Total retail doubtful debt cost	Credit notes raised when a customer vacates a premises	Revised retail doubtful debt cost	Household %*	Revised household cost	Revised CTS	Original CTS	Difference
					D+E		F*G	H/C*1000		I-J
		000s	£m	£m	£m	%	£m	£	£	£
ANH	WaSC	2,681.43	33.886	0	33.886	87.7%	29.714	11.08	11.08	-
WSH	WaSC	1,344.62	26.953	0	26.953	71.9%	19.371	14.41	14.41	-
NES	WaSC	1,828.55	18.400	0	18.400	92.9%	17.100	9.35	9.35	-
SVT	WaSC	4,035.52	31.200	0	31.200	85.6%	26.700	6.62	6.62	-
SWT	WaSC	705.02	14.700	0	14.700	98.0%	14.400	20.42	20.42	-
SRN	WaSC	1,805.08	26.800	0	26.800	98.9%	26.500	14.68	14.68	-
TMS	WaSC	5,210.60	70.600	0	70.600	85.8%	60.600	11.63	11.63	-
NWT	WaSC	2,896.97	67.500	0	67.500	93.5%	63.100	21.78	21.78	-
WSX	WaSC	1,112.17	10.100	0	10.100	90.1%	9.100	8.18	8.18	-
YKY	WaSC	2,087.05	15.276	0.642	15.918	86.4%	13.745	6.59	6.32	0.27
AFW	WOC	1,322.01	6.629	0	6.629	84.4%	5.598	4.23	4.23	-
BRL	WOC	465.90	2.500	0	2.500	75.8%	1.896	4.07	4.07	-
CAM/SST	WOC	639.55	2.756	0	2.756	84.4%	2.326	3.64	3.64	-
DVW	WOC	111.09	0.440	0	0.440	89.5%	0.394	3.55	3.55	-
PRT	WOC	279.67	0.535	0	0.535	96.4%	0.516	1.85	1.85	-
SBW	WOC	183.90	0.356	0	0.356	78.9%	0.281	1.53	1.53	-
SEW	WOC	804.38	3.455	0	3.455	90.1%	3.114	3.87	3.87	-
SES	WOC	257.89	0.340	0	0.340	80.9%	0.275	1.07	1.07	-
		27,771.40								
Weighted average								**10.61**	**10.59**	

Key	
*	Calculated using household data from table 2 row 4