







of years with the introduction of international financial reporting standards and iXBRL tagging could be time consuming and expensive.

### **Accounting separation**

- Q5. *We propose to provide companies with the principles and business unit summaries in appendix 4 to use when allocating their costs, rather than publishing prescriptive guidance. Do you agree with this approach? If not, please provide details of an alternative approach you think we should adopt.*

We support adopting a principles based approach and believe there would be no significant impact from adopting this approach compared to the current more prescriptive guidance that is followed.

- Q6. *Do you think there are areas of expenditure that are at high risk of companies classifying inappropriately? If yes, please provide evidence and advise how we could mitigate this risk in a proportionate way.*

Following a principles based approach, we are not aware of any allocations that would be inappropriately applied.

However, with the proposed increase in accounting separation services to 15 from 9, the split of water distribution between trunk and local and the split of sewerage services into foul, surface water and highway presents a higher risk of inconsistency between companies and less robust cost allocation. Data is not currently captured in a way to allow these allocations to be made, especially in the area of sewerage, where one sewer can transport different sources of waste water.

- Q7. *We are proposing to merge the sludge treatment and sludge disposal business units into one called sludge treatment, recycling and disposal. Do you agree with this approach?*

Yes, we are happy to support this approach.

- Q8. *We are proposing that all fixed assets should be recorded in the business unit of principal use. Do you agree with this approach? For some asset categories such as general and support expenditure (G&S) that have no natural business unit should we allow them to be allocated or should we require the approach described above for fixed assets?*

We have no concerns with recording water and waste assets in the business unit of principal use, however this does present difficulties with G&S assets such as IT systems which do not have one principal use. To allocate these assets would introduce inconsistency into the methodology. We do not feel that one answer is significantly preferential to another.

Q9. *We are proposing to trial the allocation of operating costs to services as detailed in appendix 6. As well as the service definitions in appendix 6, what information would companies need in order to report costs by these services? What incremental costs do you expect companies would incur in order to report operating costs by the proposed services to the same level of assurance as the regulatory accounts? What are the implementation options available to companies to report operating costs by these services?*

Cost allocation into the additional service areas would currently be dependent upon management estimates and spread sheet allocations. This method may produce a suitably material cost allocation for historic data but we would not be able to produce business plan or forecast data in this way.

In order to collect the data at the correct level of detail in the financial ledger for a longer term solution, cost centre structures would need to be rebuilt, with the addition of an estimated 900 additional cost centres. There would also be the challenge of ensuring there were suitable processes in place to help colleagues select the correct cost centre from a significantly increased selection for any job. We have provided further detail on our ability to allocate costs into these additional categories as part of the Regulatory Accounts Working Group trial.

The forecast of what incremental costs would be incurred would be dependent on the final service areas to be included. For example if we were required to split sewerage into foul, surface water and highway incremental costs could be significant and could cover the following:

- New assets to collect flow data throughout the region;
- Re-design of financial hierarchies;
- Re-design of work management systems to ensure costs are captured appropriately into new categories;
- Significant staff training to ensure new work management system and cost hierarchies are understood and used appropriately.

The actual costs incurred would depend on the final data capture solution selected.

