Northern Ireland Water Ltd
Annual Information Return 2013

Part 1 of 9 containing:
Reporter's Report on the Board Overview

Public Domain Submission
23 October 2013

Halcrow

Reporter's Commentary on the Board Overview

1. Basis of Opinion

In accordance with its Instrument of Appointment, Northern Ireland Water Ltd (NI Water) has appointed Halcrow Management Sciences Ltd, a ring-fenced member of the CH2M Hill Group, to provide reporting services to the Northern Ireland Authority for Utility Regulation (UR). The UR regulates the appointment and work of Reporters by a Protocol which formally sets out the mechanism for appointment and the tasks that the UR requires of Reporters.

The Reporter for NI Water, Chris Turner, supported by a team of technical and operational specialists, has examined, tested and provided opinion on the information provided by the Company in its Annual Information Return 2013.

The Reporter's work includes:

- assessing the Company's compliance with the UR's reporting requirements and guidelines,
- ensuring that the Company's material assumptions have been exposed and explained, and
- the preparation of a written report, together with a professional opinion on the Company's processes for developing its submission and on the accuracy and reliability of the information.

In accordance with our appointment, we have carried out checks on the Company's reporting processes and examined the data in the context of our knowledge of NI Water's activities and the prevailing conditions in the regulated water sector. We have examined and provided opinion on the Company's tables, commentaries and other information forming its Annual Information Return 2013 to the UR.

We would like to thank NI Water for the time and assistance they have afforded throughout the 2012/13 audits. We have received full co-operation from NI Water and have had sufficient and timely access to the staff and information that we reasonably require to form our opinions. We have no reason to believe that any relevant information has been withheld.

2. NI Water's Governance of the Annual Information Return

In the Board's Overview, which accompanies the AIR13 submission, NI Water describes the processes and internal systems of control which have been applied to the preparation of their submission.

In accordance with our appointment, we have carried out checks on the Company's reporting processes and examined the data in the context of our knowledge of NI Water's activities and the prevailing conditions in the regulated water sector. We have examined and provided opinion on the Company's tables, commentaries, compilation methodologies and other information forming its Annual Information Return 2013 to NIAUR.

To the extent we are required to audit and comment upon the financial measures information, we confirm that methodologies also exist for these tables. Any departures from the Company's prescribed methodologies that we have identified during the course of our work have been brought to the Company's attention and, where material, are reported on in our detailed commentaries or where of concern, have been escalated into this report.

As stated in their Board's Overview, NI Water has compiled their AIR submission in accordance with their AIR Completion Manual (ACM). We confirm that this document addresses our key observations and recommendations from AIR09 and AIR10 for enhancing the regulatory reporting processes and information quality.

All requirements and responsibilities are disseminated into the Directorates through the AIR Project Board. The project management team then communicates with the full team directly. We found that line authors, reviewers/checkers, and approvers (level 3 manager or above) were identifiable for all AIR entries. As AIR information is reported to the Finance and Regulation team and approvals from senior management are received, the data is locked down and thereafter a formal change control takes effect.

We note that NI Water continues to make enhancements to their approach, with associated benefits to their methodologies and quality assurance procedures, resulting in a greater understanding of, and confidence in, their reported data. In particular, the ACM requires assurance statements to be produced. These provide evidence of sign-off by the authors, reviewers and level 3 managers of the line methodologies, data and commentaries.

We also note that the actions pertaining to any recommendations made by the Reporter, Auditor, Internal Auditor or Regulator are now monitored by the Director of Finance and Regulation (a recommendation from 2010/11).

Queries and clarifications are co-ordinated by the Economic Regulation (project management) team but referenced and passed through to the relevant staff for information/resolution. The Economic Regulation team also maintain control of the definitive version of the AIR document, including the issue of any errata.

We have carefully considered the Board's statement on the compilation of the Annual Information Return and, except as identified below or in our Main Report, we consider that:

- The measures and procedures they describe are consistent with those we observe being implemented during our audits of the AIR information
- Material assumptions embedded within the Company's procedures appear reasonable
- The report adequately represents NI Water's activities and performance in the Report Year
- The information reported in the AIR is consistent with the Reporting Requirements
- NI Water has established suitable procedures for collecting and reporting the required information with reasonable consistency and accuracy (and consistent with the confidence grades. where given)
- The processes of control of AIR information by the Finance and Regulation team appear to be sound, and simple but reasonable systems are in place to manage and check that the information they receive has been duly approved
- They continue to enhance their corporate governance and QA processes and have applied them to the preparation of this submission
- Senior managers and Directors are required to approve and thereby assume accountability for the integrity of the regulatory information provided.

We are also able to confirm the degree of involvement of the Board in the production and completion of the AIR submission. We have witnessed Board and Executive Team meeting minutes which demonstrate that Regulatory information submissions have been an important focus of their attention. Indeed, significant time and resource is invested by NI Water in regulatory submissions and we consider that this is the result of the importance with which the supply of reliable, accurate and complete information is held, and also the speed at which the Company is trying to catch up by improving their fundamental systems and processes.

Our commentaries on each of the AIR tables provide further detail of our findings on the processes and methodologies, assumptions and sources of information which are employed to assemble the components of reported data and the degree of compliance (against the reporting guidelines) that has been achieved.

We therefore consider that NI Water's Annual Information Return process is appropriate for generating suitable information for the submission and has been effectively implemented for producing AIR13.

3. Consistency Checks

3.1 Reconciliation between the Board's Overview to AIR13

We confirm the consistency of the Report Year information in Tables A to E in the Board's Overview with the relevant information provided in the AIR tables as follows:

- Table A - Fully consistent except:
  - Line 20 should equal to T11 L11: **93**
- Table B - Fully consistent.
- Table C - Blocks A & B only checked. Fully consistent.
- Table D - Fully consistent.
- Table E - Fully consistent, except:
  - Line 21 Col 2011-12 should equal T3 L6 09-10 minus T3 L6 11-12: **-18**
  - Line 21 Col 2012-13 should equal T3 L6 09-10 minus T3 L6 12-13: **-36**

3.2 Table 44 – Overall performance assessment

Table 44 is consistent with other sections of the AIR and the processing rules have been followed.

4. Summary of Key Findings

In the following sections, we summarise the principal issues arising from our audit work. Further information and background is contained in our detailed table commentaries.

4.1 Levels of Service Information Tables

Table 1 - Water efficiency

During the report year the Company identified that in previous submissions the number of supply pipe repairs (line 1) has included both household and non-household properties. The entry for AIR13 includes only household properties. The Company has also calculated the impact on previous returns, which suggest an over-reporting of ca. 12-15%.

As the Company does not offer a free supply-pipe repair or replacement service it is unable to distinguish between external supply pipe leakage repairs and internal plumbing losses. Analysis has determined that offering a free supply pipe repair/replacement policy is not cost beneficial.

The Company's Water Efficiency policies are in-line with those employed by water companies in England & Wales. NI Water makes more use of 'soft' measures, so would expect to achieve a higher installation rate and therefore be more efficient. However, the lack of domestic metering (customer have less incentives to save water) and not being funded to provide a free/subsidised supply-pipe repair/replacement policy, limit the success of some of the measures.

Table 2 - DG2 - Properties receiving pressure/flow below reference level

A total of 328 properties were removed from the register in 2012/13, due to a combination of mains rehabilitation and better information. They have thus exceeded, by 42 (5%), the PC10 target of removing 800 properties from the DG2 register. Furthermore, they also have a number of schemes in place which should enable them to meet the 2013-14 target.

The DG2 Register contains full documentary evidence for properties that remain, are added or are removed from the register.

NI Water has investigated properties on the register with pressure below 7.5m, and this number has increased slightly to 138 properties from 133 at AIR12.

NI Water has estimated the average cost of removing properties from the DG2 register as £818.6/property, although this remains an approximation as the cost is derived from schemes that have a range of different investment drivers.

Table 2 - DG3: Interruptions to supply

Except in the greater than 3 hours category, NI Water reports an increase in the

number of properties experiencing a supply interruption. The Company explained that a proportion of this increase is due to the bad weather in March 2013 which resulted in a number of power outages and loss of supplies. However, despite these interruptions, the underlying performance in the greater than 6, 12 and 24 hour duration categories has deteriorated from that reported in 11/12. This could be explained by 11/12 being a relatively benign year in terms of weather impacts but the reported 12/13 performance still exceeds the PC10 targets.

In AIR12 we made the recommendation that the warning times given to customers were reviewed as we found a number of incidents where supplies were restored well within the warned interruption envelope. We are pleased to report that as a result of this observation, NI Water has amended their approach to notifying and warning some customers which has the consequence of decreasing the average duration between warned end times and actual shut down times by circa 50%. From a customer perspective this reduces the warned duration window, improves service predictability and should therefore be of benefit to customers.

Table 3 - Sewerage Service – Internal Flooding

Whilst 2012/13 has been a period of consolidation, with minimal refinement made to the overall sewer flooding process during the year, we consider the Company has made considerable progress over the PC10 period and introduced a relatively high level of rigour to the overall flooding process.

During the year, NI Water received 656 internal flooding contacts. Although this represents a 57% increase on the 419 contacts reported in AIR12, a high proportion (circa 310) of the contacts related to the severe weather event experienced on 27th June 2012. On this basis, 346 other contacts were received during the year, which is 17% lower than AIR12.

NI Water initially reported that 12 incidents of internal flooding had occurred during 2012/13, however, our subsequent review of the details for each incident, identified that four of the properties were added as a result of further investigations carried out during the year, and the properties had not actually flooded during the year. We advised that the four properties should be included as 'Better Information Additions' and T3 L2&3 should be reduced from 12 to 8. We confirm that the table was subsequently amended post audit, and the Company are now correctly reporting 8 incidents of internal flooding in T3 L2.

We note that the Maintenance Contractor was not always completing an FIR for incidents that did not require a clean-up. For the process to be effective, it is important that sufficient levels of detailed information are collected at the time of the incident and on site, to ensure appropriate categorisation and to ensure all affected properties are identified.

The heavy rainfall experienced during the year, highlighted the vagaries of the Met Office rainfall reports and highlighted the benefits (if cost effective) of the Company undertaking their own rainfall radar analysis to assess storm return periods.

As DG5 performance has been relatively consistent over the past four years, and we

have a better understanding of the nature of the excluded DG5 contacts, we are increasingly of the view that the overall sewerage design and network configuration may be the main explanatory factor for low levels of internal flooding reported in Northern Ireland.

NI Water continues to be a low outlier in terms of FOC (blockage) incidents, despite experiencing circa 3-4 times more blockages/km than Scotland and E&W. During our review of one particular incident, we noticed that the street had been subject to repeated blockages (circa 50), suggesting there are possibly structural issues with the sewer. We also note that NI Water only has a small Sewer Main Rehabilitation Programme (SMRP) for PC10 (63km). We consider that the lack of a targeted and focussed SMRP may have contributed to the disproportionately large number of blockages reported in the year (circa 21,000).

We identified that a number of the capital schemes reviewed were actually delivered in 2011/12, but were not claimed until 2012/13. It appears that NI Water's Engineering Procurement was not informing the DG5 Panel when schemes were completed. We were advised that systems have now been improved to ensure the DG5 Panel are automatically notified of the 'beneficial use dates' of DG5 schemes, to ensure outputs are claimed in the year they are delivered.

NI Water has reported a relatively low average capex cost for the 1in20 outputs delivered in AIR13. This is largely due to the impact of the Omagh scheme which delivered 51 outputs at a capital cost of £2.2m (£43k/output). Whilst high output, low unit cost schemes are indicative of a large DG5 programme, the small number of properties currently on the NI Water DG5 Register suggests that similar large schemes are unlikely to occur very frequently, consequently the average unit cost is likely to be higher in future years.

NI Water has now delivered 84 removals by company action over the PC10 period, which is circa 59 outputs lower than was initially forecast. However, as the Company are experiencing fewer than 10 DG5 incidents per year, we do not consider a large DG5 capital programme going forward to be justified. For PC15, we consider it may be prudent for the Company to develop solutions for all properties on the Flooding Registers and then prioritise delivery of these on a cost beneficial/highest impact basis, delivering a modest programme for PC15.

Table 3a - External flooding

For AIR13, NI Water has produced a written methodology for the collection and reporting of external flooding incidents and some investigation of incidents has taken place throughout the year. However, the process is still heavily dependent on the assumption that information provided by the maintenance contractor is accurate and complete.

Accordingly, NI Water has reported 225 incidents of external flooding due to overloaded sewers for AIR13, and 3,576 incidents of external flooding due to other causes. NI Water has investigated circa 100 external flooding incidents during the year and this has highlighted some of the inadequacies of the information collected by the maintenance contractor for each incident.

Whilst there is a contractual obligation for the maintenance contractor to collect sufficient levels of detail at each incident, we have seen little evidence of improvement over the years, severely restricting the Company's ability to understand and report on the true flooding liability. As such, it may be prudent to remove the responsibility for data collection from the maintenance contractor, and for the local Customer Field Manager (CFM) to take ownership of the flooding incidents reported in his/her area.

For AIR13, NI Water has started to populate an external flooding risk register. Those incidents which occurred during the year and were deemed to have been caused by 'hydraulic overloading', and were not due to severe weather have been transferred to the 'At Risk' Register.

Table 4 - DG6: Response to billing contacts

NI Water report a 17% reduction in billing contacts received. The Company has embarked on a number of initiatives which appear to have reduced contact volumes. In terms of responding to DG6 billing contacts, the Company has reported that they dealt with over 100% of contacts within 10 working days. Achieving over 100% is possible because NI Water report the actual number of complaints received in the Report Year whilst the number of contacts considered 'responded to' is the number of open contacts responded to in the Year. A percentage of 100% therefore indicates that the Company has closed more contacts than it has received during the year (ie some carry-over from the previous year) and care should therefore be taken when interpreting relative performance trends.

Table 5 - DG7: Response to written complaints

The volume of complaints has increased by 36%, or 833 complaints in real terms. Increases have been attributed to the conclusion of the test meter project which has resulted in a number of disputed liability contacts and also the relatively wet summer which resulted in a number of flooding events.

Table 5 - DG8: Bills for metered customers

The Company report that 98.70% of customers received a bill based on a meter reading in 2012/13. This is ahead of the Company's PC10 target which was 98.5% and also an improvement on the percentage reported in the previous year.

Table 5 - DG9: Telephone contact

Overall call volumes in 2012/13 have decreased but the abandonment rate has increased from that reported previously. NI Water explained this was largely the result of an unexpected rainfall event in June 2012 which resulted in a peak of calls which they were unable to be answer via the contact centre. In addition, the introduction of the High Call Volume Answering (HCVA) system has also resulted in an increase in the number of abandoned calls.

We noted that the reported number of telephone complaints had increased significantly (which followed an observed large decrease in the preceding year). NI

Water explained that their own internal assurance procedures had highlighted inconsistencies in the way in which call agents were interpreting how complaints should be logged. Whilst steps to correct these inconsistencies have already been taken, care should be taken when interpreting historic trend information.

Table 5 - Special assistance register

The number of customers registered on the scheme has increased significantly. We believe this is a combination of efforts to promote awareness amongst the customer base.

Table 5a - DG7 Response to Written Complaints (complaints data for CCNI)

We believe NI Water's methodology is now satisfactory. The risk of misclassification has been reduced as closing CMS codings are now used rather than open (pre investigative) codings.

4.2 Water Service Information Tables

Table 7 - Non financial measures – Water population only

We are able to reconcile the property numbers reported to the Rapid extract presented by NI Water. However, there remain some anomalies in the new connections data.

We note there are circa 2,000 potential NHH properties which are still awaiting assessment and not included in this table. These are potentially billable customers and as such, NI Water should confirm the status of these properties as soon as reasonably practicable.

We believe that the confidence grades for property numbers should remain consistent with those agreed in Undertaking A.

Table 8 - Non financial measures – Water Metering

The Company has not met the targets set out within PC10 Appendix 19 of their response to the draft determination; a total of 454 installations have been reported against a target of 1,000 (747/1000 in 2011/12). The Company explained that it had undertaken surveys at 3,731 properties but was unable to install a meter for a number of reasons, the most significant problem, which accounted for 943 of the surveys was the property being on shared supplies.

There is a significant difference between the number of domestic meters installed (Table 8, line 1) and the number of new domestic properties (Table 7, line 1). This data is derived from different sources, but we consider the current difference is too large to be due to phasing issues. The Company identified unsatisfactory reporting processes within their metering contractor to be a principal contributory cause.

We believe that the Company does not currently capture appropriate data for water demand at recently metered properties as the methodology includes consumption from the properties which had not completed the first year of measured charging in the reporting year.

Table 9 - Non financial measures: Water quality

Although some indicators have deteriorated slightly from the previous year, water quality indicators generally remain good.

No existing or new ‘Legal Instruments of Work’ or Authorised Departures for distribution input are in effect.

Table 10 - Water Delivered

The Company has reported a fall in leakage from 168 Ml/d to 162 Ml/d. However, an improved leakage management software package has now been implemented and the Company estimates the revised method of calculation will lead to an increase in leakage of approximately 8 Ml/d. We understand that this change has been

recognised by the Regulator when setting the AIR14 leakage target of 169 Ml/d.

The Company has maintained a number of assumptions used within the leakage calculation (such as hour to day factor and night use allowances for example) consistent through the PC10 period. We recommend that these are now updated, which the Company intends to do as part of Sustainable Economic Level of Leakage (SELL) update. The Company has provided a detailed commentary on the water balance for AIR13.

Table 10a - Security of Supply Index

The SOSI has been calculated by reference to figures contained within the Water Resources Management Plan and has achieved a SOSI score of 100, which has largely been driven by lower distribution input.

In recognition of the cool/wet weather experienced in 2012-13 the Company has applied both a normal year uplift (+5%) and a dry-year uplift (+7%) to the report year distribution input. We consider this a reasonable approach, but recommend the company investigates if data exists to further refine the normal year uplift for possible use in future years.

Table 11 - Water Service Activities

NI Water has outperformed their PC10 water mains rehabilitation programme by 140km, with 1040km of mains delivered.

All Zonal Study models have now been completed, and plans are in place to start the updating of the oldest models.

The continuing reduction in the number of mains bursts reported (line 11) can largely be attributed to the success of the mains renewal programme and continual improvements in data quality.

Table 11a - Water Serviceability Indicators

Although other serviceability indicators suggest that the asset base is reasonably stable, the level of failures in the number of works with 95%ile greater than or equal to 0.5NTU is increasing.

The proportion of total output volume of these failures remains high at almost 77%, primarily due to exceedences at Drumaroad WTW. However no sites exceeded the 95 percentile value >1.0 NTU and the Company is undertaking appropriate measures to rectify the issues at each site.

Table 12 - Water Explanatory Factors

NI Water has changed the methodology used in the counting of impounding reservoirs and river abstractions supplying some WTWs. The new method moves away from the guidelines issues by the Regulator, and results in the counting of some sources which are fed by further upstream reservoirs, and whether all

reservoirs in the system should be counted or whether only the final reservoir that feeds the works should be counted.

The programme of removal from service of low-treatment level works supplied by borehole sources has concluded and only one such source now remains.

Positive steps have been taken to improve pump head data reliability via new telemetry systems at key pump sites and this has resulted in a significant reduction in the calculated Average Pumping Head. The significant year to year variations in the calculated Average Pumping Head indicates that there are ongoing problems in the calculation methodology. We have suggested a step by step plan to identify the most significant sources of error, and a plan to try to improve the quality of the data. The accuracy of the calculation depends on (a) the accuracy of the list of pumps, (b) the accuracy of the average flow recorded for each pump, and (c) the accuracy of the pumping head estimated or recorded for each pump, and there is still evidence to suggest that a number of small booster pumps have still not been identified and included in the calculation.

4.3 Sewerage Service Information Tables

Table 13 - Non financial measures – Sewerage properties and population

We are able to reconcile the property numbers reported to the Rapid extract presented by NI Water. However, there remain some anomalies in the new connections data.

We note there are circa 2,000 potential NHH properties which are still awaiting assessment and not included in this table. These are potentially billable customers and as such, NI Water should confirm the status of these properties as soon as reasonably practicable.

We believe that the confidence grades for property numbers should remain consistent with those agreed in Undertaking A.

Table 14 - Non financial measures – Sewage collected

The confidence grades for Lines 1 to 3 are improved from C3 to A2, and Line 7 is also improved from C3 to B3. However, we still believe the confidence grades should remain as those assigned in AIR11.

Table 15 - Non financial measures – Sewage treatment

Changes in the methodology and the sites included have resulted in a material change in the trade effluent loads reported. However, after allowing for a miscalculation of the incinerator volume in AIR12, there was no real difference in overall BOD loading as the revised loading was 5380 tonnes/year compared to reported 5357 tonnes/year.

Ongoing investigations into actual trade volumes from Hospitals indicate that in some instances the trade discharge element is greater than the anticipated 5%.

NI Water is continuing to invest in flow and load surveys and analysis to improve their understanding and the accuracy of their estimates.

There is a small (1.9%) increase in sludge produced for the year compared to the previous reporting year.

Grit and screenings from PPP sites have been reported for the first time.

Table 16 - Sewerage service activities

No Drainage Area Plans have been completed in this year and there is only one ongoing at present. This was due to procurement issues deferring the start of the new framework.

The numbers of reported collapses and blockages are improving year on year, but are still very high when compared to E&W water companies. We consider a targeted WwMRP would help to further improve performance.

The Company are now able to report on the time required to repair a blockage (Lines 13a-13c), and have reported that circa 6% of total blockages in 2012/13, required in excess of 6 hours to repair.

Table 16a - Sewerage service serviceability indicators

NI Water are now able to separately identify blockages occurring on the public main sewer, public laterals and private laterals, and have been reporting on this basis since April 2013.

For the first two months of 2013/14, NI Water confirmed that only 17 of the 1809 blockages reported, actually occurred on a public lateral.

Table 16b - Sewerage Serviceability Indicators

Overall, performance across all indicators appears to be reasonably stable.

Table 17a - Sewerage Sub-Area Explanatory Factors

NI Water is not able to disaggregate the data in this table into sub-areas, although work is ongoing to facilitate this.

Table 17b - Sewage Treatment Works – Large Works Information Database

The Company has identified 15 large works, each of which has its own location code to enable the identification of related costs.

Only one power meter exists at each site. Where a treatment works provides both sewerage and sludge treatment facilities, the costs are split on the basis of the judgement of operational staff.

Table 17c – Sewage Treatment Works - Numbers

There are no material areas of concern regarding the data in this table.

Table 17d – Sewage Treatment Works – Loads

There are no material areas of concern regarding the data in this table.

Table 17f - Sewage Treatment Works - Costs

NI Water is increasingly relying on the cost to serve project to assign all costs for this table. It estimates that around 80% of costs are directly attributable, based on the cost to serve project, whilst the remainder are allocated on the basis of population equivalents. In future years the cost to serve project is likely to be able to allocate more than 80% of costs directly, though it is believed there will always be a residual cost value that is allocated on a different basis.

Table 17g - Sludge Treatment and Disposal Information

The costing data is extracted from the Company's general ledger system. Some assumptions are required to apportion costs between categories. We believe these are appropriate in the absence of more relevant data.

4.4 Financial Tables

Table 21 - Activity costing analysis – Water, and
Table 22 - Activity costing analysis - Sewerage

Total operating expenditure is reported at £172m. This represents a minor increase in nominal terms, but a real reduction in operating costs. Key drivers on the upside are increases in the unit cost of electricity. Ni Water is still formulating its strategy to address this but should seek to mitigate any future increases.

The Company maintains its business improvement program and the voluntary severance scheme as a means to reduce its long term cost base. It reports these as atypical costs.

For AIR13 the Company has split out service charges from the General and Support cost lines at the request of the Regulator.

The proportion of General and Support costs relative to direct costs is relatively high compared to England and Wales. However we note a general reduction in these costs over the last few years. For AIR13, NI Water reports a further drop (27% for water and 9% for sewerage).

The cost data relies on a combination of service activity codes, expense codes and responsibility codes. In the majority of cases this is sufficient to report data for the purposes of tables 21 and 22. However, some costs do not neatly fit into the coding structure and the coding requires additional definition to ensure that NI Water is able to report with sufficient accuracy at lower levels of granularity.

Costs for the PPP table remain broadly the same apart from an increase in the provision for contractor claims, see table 42 below.

Table 25 - Analysis of fixed assets by asset type

The Company advised that it has not made any AMP adjustments in this table for AIR12. We note nevertheless that NI Water has added some values to lines 7, 11, 12, 13 and 14 for infrastructure assets. These relate to disposals, charge for year and depreciation at 31 March. We note that no cells exist for this data. We understand from NI Water that the financial auditors consider that this approach conforms to the reporting standards.

Table 32 - Fixed asset additions and maintenance by asset type

NI Water's proportional allocation procedures are now well established and consistently applied and we are finding fewer instances where the allocation of expenditure between purpose categories requires adjustment.

Table 33 - Depreciation charge by asset type

We note significant accelerated depreciation in the year, which follows similar levels of acceleration reported in AIR12, AIR11 and AIR10. We suggest that NI Water should aim to achieve a stable accelerated depreciation position.

NI Water seems to make a one way downward adjustment for impaired assets which could impact on the value of the GMEAV. NI Water advised that they have taken advice from their external financial auditors and this approach is consistent with UKGAAP.

NI Water is putting through accelerated depreciation on infrastructure assets. This seems to be at odds with RAB and IRC type financing. NI Water advised that the financial auditors are content with this approach.

Historically the IRC was based on a 10 year average. However for PC10 and now PC13 the IRC calculation is based on the final determination. The Company advised that the Utility Regulator has determined that the IRC and IRE would be the same for the years covered by PC13.

Overall the Company has a relatively small prepayment balance of £3.341m. We note however that there is a significant variance between water and sewerage. For Water, NI Water has a prepayment of £13.653 million, whilst for Sewerage, NI Water has an accrual of £10.3 million. This suggests that planning could be improved to avoid such significant variances.

Table 34 - Analysis of non-infrastructure fixed asset additions by life category

Although NI Water has 3 year plans, its status means that all budgets have to be spent in the year allocated, resulting in potential inefficient expenditure.

The appropriateness of the average asset lives was reviewed in our audits of the PC10 submissions in 2009. In general, these were deemed to be satisfactory and in line with assumptions employed elsewhere. We do believe however that the overall asset lives available should be extended to ensure that the economic life of an asset is consistent with its financial life.

The audit trail for the basis of the split of assets is not transparent, although there have been some moves to improve the assessment for this.

We did review the allocation of expenditure contained in business cases submitted to the investment board. We noted that in some cases the asset allocation section of that document was not populated, whilst in other cases incorrect asset lives where being assigned.

Table 35 - Water Service – Expenditure by Purpose

We note a 16% decrease in overall capital expenditure in Year 3 of PC10 when compared to the forecast PC10 expenditure profile for Year 3, as a result of the re-profiling of Public Expenditure (PE) funding. The PE budget initially required a £36m

reduction in expenditure against the PC10 budget for 2012/13, however during the year, PE was revised by the DRD, and an additional £12m was made available, which has helped to reduce the overall variance.

Against an overall PC10 programme of 900km of water mains activity, NI Water has out-turned at 1040km of new and replacement mains. We consider the reported outperformance of the WMRP reflected the relative uncertainty of funding, due to revisions in PE.

Management and General (M&G) expenditure accounted for 48% of the MNI spend for the year, which is higher than that reported previously and higher than we normally find at companies in E&W, where M&G spend has typically been 25% of MNI. We found that NI Water has charged expenditure associated with feasibility studies to M&G, which is not consistent with E&W. For AIR13, feasibility related expenditure accounts for circa 20% of total M&G expenditure.

We note that there were very few outputs delivered against the PC10 water capital programme during the report year, with the majority of the outputs that were outstanding in 2011/12, deferred to PC13/PC15.

Table 35a - Water Service – Expenditure Variance from FD

NIAUR has provided a breakdown of the annual PC10 projections on the basis of QBEG, to enable population of Table 35a.

PC10 has been adjusted using actual COPI, resulting in a slight increase in forecast expenditure for Year 3.

Whilst some variance has been reported amongst purpose categories, particularly IRE, overall expenditure in Year 3 of PC10 is in line with the adjusted PE allowance for Year 3, with the PC10 water programme substantially complete.

Table 36 - Sewerage Service – Expenditure by Purpose

We note a 12% decrease in overall capex in Year 3 of PC10 (£92.7m) when compared to the forecast PC10 expenditure profile for Year 3 (£105.2m). The decrease in expenditure reflects the re-profiling of Public Expenditure (PE) funding.

The Sewer Mains Rehabilitation Programme (SMRP) was forecast to deliver 56km of critical and 8km of non-critical sewer improvements over PC10. Whilst the total 64km length was delivered, the Company has only delivered 24km of critical sewer improvements with the balance non-critical. When taken in the context of poor blockage performance in NI (when compared to E&W), the low levels of capital investment in the SMRP may be a significant contributory factor to the disproportionately large number of blockages reported in the year (circa 21,000). We recommend that the cause of these high numbers is investigated to determine whether other causes may be contributing (eg the counting methodology, contractual arrangements, network attributes). Nonetheless, there do appear to be some significant repeat blockage hotspots where a targeted approach would be most cost beneficial.

NI Water has a large WwTW programme for PC10, with 14 PC10 WwTW outputs and 30 SBP Carryover WwTW outputs forecast for delivery during the period. At the end of PC10, one SBP carryover scheme and six original PC10 schemes were still outstanding. We found that the outstanding SBP scheme, Ardglass, was currently under construction, with a forecast completion date of 2014/15. Of the six outstanding PC10 schemes all but one was currently under construction with forecast completion dates in 2013/14 or 2014/15.

NI Water had committed to the delivery of a large UID programme over the PC10 period, with circa 117 outputs initially forecast for delivery. Overall, NI Water has delivered a UID programme of a similar magnitude for PC10 (with 101 outputs delivered), but of a significantly different scope, where only 42 of those originally identified were delivered.

Land acquisition issues are apparent in the delivery of the PC10 programme. We note that NI Water are limited to only paying 'Land Authority' valuations when it comes to purchasing additional land for capital schemes, severely restricting the Company's ability to deliver the Capital Programme in a timely manner.

Table 36a - Sewerage Service – Expenditure Variance from FD

NIAUR has provided a breakdown of the annual PC10 projections on the basis of QBEG, to enable population of Table 36a.

PC10 has been adjusted using actual COPI, resulting in a slight increase in forecast expenditure for Year 3.

Whilst some variance has been reported amongst purpose categories, overall expenditure in Year 3 of PC10 is in line with the adjusted PE allowance for Year 3.

The Company has broadly delivered the PC10 WwTW and UID programme, although the outputs include a large number of sites that were not initially identified.

Table 40 - Capital Investment Monitoring Return

The Company has provided a detailed account of the differences by sub-programme. However, it is clear that the PC10 assumptions have been materially superseded by the changes caused by the PE10 and the PE10 Monitoring Plan. Table 40 baseline date information has also been superseded.

Overall, we believe that the allocation of investment into service areas and asset types has been done reasonably well.

The '16-box model' derived from Table 40 is materially consistent with Table 32 and Tables 35 and 36.

We understand that WwTW schemes in the PC10 programmes have been/are being designed to new drivers/standards and that it is highly likely that there will be material cost implications which are currently being absorbed. We have not seen any clear mechanism which identifies and accounts for output and/or cost variations and

recommend that an appropriate process is devised, agreed and put into effect as soon as is practicable.

Table 42 - PPP Data

Data from the PPP sites is generally deemed to be of good quality. Aggregated data is generally similar to 2011/12.

There has been an increase in atypical costs of £3.334 for the Omega contract dispute increasing the amount of the total provision to £12.55m for this contract dispute.

There has been more than £500k of efficiency gains reported for AIR13.

Table 43 - PPP Operating costs

In order to report data for some lines, the Company has had to rely on data from external sources.

Some apportionments and assessments are required to report the data. Where these have been applied we believe they are appropriate and likely to result in data that is reflective of the actual position.

4.5 Additional Information

Table 41 – Health & Safety – Policy & Performance

The Company improved in 'occupational ill health' rate, while their 'days lost' rate deteriorated slightly from previous year.

We would encourage NI Water to assess the feasibility of capturing contractors' H&S information.

Table 45 – Carbon accounting

Whilst we confirm that NI Water has a Climate Change Mitigation Strategy in place, it is largely founded on the basis of seeking new routes to greener energy rather than improving energy efficiency and, with the PE budgets not being sufficient to allow for such long term strategic investments, there is little tangible progress being made at present.

Improving the accuracy of the Flow to Full Treatment figure needs to be considered in the future.

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Reporter for Northern Ireland Water Ltd

Halcrow Management Sciences Ltd
29 July 2013