


Northern Ireland Water Ltd Annual Information Return 2012

Part 5 of 10 containing:
Regulatory Accounts - commentaries for tables 21, 22 and 25

Public Domain Submission
3 December 2012

Table 21 and 22- Activity Costing Analysis - Water and Sewerage Service**Commentary by REPORTER****1. Background**

This table collects information on operating costs and maintenance costs. The information from this table is used to identify trends in operating costs and also to derive annual unit cost comparisons between companies.

2. Key Findings

- The Company has applied the same method to the completion of these tables for AIR12 compared to AIR11.
- We consider that the Company approach to the allocation of cost data is capable of reporting as required;
- For the Report Year the proportion of General and Support costs relative to direct costs is 52.5%. This is a reduction from the 55% reported in AIR11. For equivalent companies in England and Wales, General and Support are in the region of 28% of total direct costs. This variation may be due to: differences in allocations as compared to England and Wales; and/or NI Water's current business transformational activities.
- The Company has reported a number of atypical costs. These are discussed in more detail below.
- The Company has not disclosed details of donations to charitable trusts or fines and provisions made against Section 74 of the Roads and Street Works Act. The Company advised that it has not incurred any such fines;
- The cost data relies on a combination of service activity code, expense code and responsibility code. In the majority of cases this should be sufficient to report data for the purposes of tables 21 and 22. However, it is possible that some costs will not neatly fit into the coding structure and the coding may require additional definition to ensure that NI Water is able to report more accurately at lower levels of granularity.

3. Audit Scope

During our audit we reviewed the company explanations for variations in costs. In addition we have commented on the procedures used for cost allocation.

We have not audited the application of the procedures described to us. The overall comment on the correctness of table 21 and 22 falls within the domain of the financial auditors.

4. Methodology (Non-PPP)

4.1 Capitalisation

The Company has a de-minimus capitalisation value of only £1,000 while land has a zero threshold. The Company further confirms that even if an item is individually worth less than £1,000, because it is part of an operational configuration, it means that the asset should still be capitalised. The Company does not capitalise interest costs incurred as part of the acquisition of an asset under UKGAAP which is used for AIR purposes.

4.2 Cost coding structure

Data in tables 21 and 22 is based on information extracted from the General Ledger. All transactions within the General Ledger are coded to a cost centre with an associated Service Activity Code, Expense Type Code and Responsibility Code. Together, these allow for the reporting of information contained in table 21 and 22. The Company advised that the activity code and expense type code together allow for the identification of the majority of expenditure for lines in tables 21 and 22. The responsibility code is used to split expenditure in cases where costs are 'general costs' such as customer services or scientific services.

The approach relies on the correct coding of expenditure to expense, activity and responsibility codes. In addition an element of judgement is required in assigning expenditure on the basis of responsibility codes.

Direct operations staff are required to complete a weekly timesheet. The Company advised that these staff form approximately 40% of the workforce. Non direct operations (salaried) staff do not complete a timesheet. Their time is allocated on the basis of responsibility codes.

In total, more than 1,050 service activity codes and expense codes are used in order to record the data in the general ledger system. Where the Company is not able to allocate expenditure using the activity code, expense type code and responsibility codes, it uses a method based on direct costs to apportion costs.

The function of each of the different types of codes, as well as the codes available is described below:

Service Activity Code

The service activity code determines the type of work being carried out. It distinguishes between the water and sewerage service activities. Within the water service activities it distinguishes between distribution and water treatment and resources. Within the wastewater service activities it distinguishes between sewerage, sewage treatment and sludge treatment. Particular service activity codes are used to capture costs of management, administration and support functions. The service activity codes are shown below:

| NIW Service Activity | Service Activity description | Table 21/22 Mapping |
|----------------------|---|--|
| 310 | Pumping (Inc Highlift at WTW) | Water - Distribution |
| 311 | Service Resv Wat Tower Tanks | |
| 312 | Service Resv cleaning | |
| 313 | Distribution and Water Operations | |
| 320 | Repair and Maintenance (Mains Repair) | |
| 321 | Repair and Maintenance (Service Repair) | |
| 322 | Repair and Maintenance (Hydrant & Valve Repairs) | |
| 323 | R&M (NIFRS Hydrant & Valve Repairs) | |
| 324 | Repair and Maintenance (Mains Cleansing) | |
| 326 | Repair and Maintenance (Lead Replacement) | |
| 331 | Repair and Maintenance of 'Street Furniture' (Water) | |
| 340 | Leakage - Monitoring | |
| 341 | Leakage - Detection | |
| 342 | Hydrant & Valve Repairs as identified by | |
| 343 | Service Repairs as identified by active | |
| 344 | Mains Repairs as identified by active Le | |
| 351 | Consumer Meter Repair & Maintenance | |
| 360 | Investigations | |
| 362 | Customer Contacts excluding meter query | |
| 363 | Regulatory Plumbing Inspection | |
| 380 | 'In House' Investigations and Attendance | |
| 385 | Health & Safety - Networks | |
| 391 | Networks Function Activity - Query | |
| 399 | Networks Stores | |
| 920 | Connection (Water) | |
| 110 | Impounding Reservoir | Water - Resource & Treatment |
| 111 | Loughs | |
| 112 | River Intakes | |
| 113 | Boreholes, Springs & Wells | |
| 120 | Repairs & Maint A/duct/Main | |
| 140 | Recreation & Amenity | |
| 150 | Water Treatment | |
| 151 | Water Sludge Treatment | |
| 152 | Water Sludge Disposal | |
| 185 | Health & Safety - Supply | |
| 190 | Supply Function Activity | |
| 191 | Supply Function Activity - Query | |
| 822 | Instrumental Control Activity M & E Water Supply | |
| 410 | Repair & Maintenance of Sewers | Sewerage - Sewerage |
| 411 | Blockage | |
| 412 | Desilting | |
| 413 | Inspection of Sewers | |
| 414 | Repair and Maintenance of 'Street Furniture' (Sewerage) | |
| 415 | Sewerage Tankering | |
| 430 | Pumping (Foul & Combined) | |
| 431 | Pumping (Surface Water) | |
| 460 | 'In House' Investigations and Attendance | |
| 462 | Rodent Control | |
| 940 | Rechargeable (Sewerage) | |
| 950 | Connection (Sewerage) | |
| 510 | Sewage Treatment | Sewerage - Sewage Treatment |
| 591 | Waste Water Function Activity - Query | |
| 620 | Sludge Treatment - Tankering Between Works | Sewerage - Sludge Treatment |
| 621 | Sludge Treatment | |
| 630 | Sludge Disposal to Agricultural Land Transportation | |
| 631 | Instrumental Control Activity M & E WasteWater | |
| 632 | Sludge Cake Transportation to Landfill | |
| 633 | Sludge Cake Disposal to Landfill | |
| 635 | Sludge Logger Maintenance (Contract) | |
| 636 | Incinerator Sludge Treatment | |
| 637 | Sludge Disposal Tankering from Strategic Collection Centres to Dewatering Centres | |
| 638 | Sludge Cake Disposal to Incinerator | |
| 639 | Incinerator Ash Disposal to Landfill | |
| 640 | Private Septic Tank Desludging | Customer Services |
| 710 | General | |
| 711 | Customer Services (Meter Read & Customer Queries) | |
| 712 | Disconnection / Reconnection | |
| 714 | Consumer Meters Repair And Maintenance | |
| 790 | Customer Services Function Activity | |
| 730 | Water Analysis | Scientific Services |
| 731 | Sewerage General | |
| 732 | Labs Water & Sewerage General | |
| 733 | Sampling | |
| 734 | Labs Sewage Sampling | |
| 003 | Rates DRC - Water | Rates |
| 013 | Rates DRC - Sewerage | |
| 910 | Rechargeable Work | Third Party Opex |
| 000 | Default | Overhead Pot 1 - General |
| 021 | GAE | |
| 023 | Invest to Save Revenue | |
| 810 | Vehicle & Plant Maintenance | |
| 811 | Vehicle & Plant Accident Repair | |
| 812 | Garage Overheads | |
| 813 | Roads Service | |
| 820 | Telemetry | |
| 890 | TMG Function Activity | |
| 050 | Ops & Maint General (Water) | |
| 055 | Ops & Maint General (Sewerage) | Overhead Pot 2 - Sewerage |
| 585 | Health & Safety - WW | |
| 590 | Waste Water Function Activity | |
| 735 | Trade Effluent | |
| 821 | Radio & Monitoring Wastewater | |
| 390 | Networks Function Activity | Overhead Pot 3 - Networks Water & Sewerage |

Expense Codes

These identify the type of expenditure such as wages, power, hired and contracted services, etc. The expense groups underlie the mapping of costs to the various lines in tables 21 and 22, particularly the direct cost lines.

| Expense Group | Desc | Table 21 & 22 mapping |
|---------------|-----------------------------------|---------------------------|
| 511X | Industrial Wages | Employment |
| 513X | Other Wage Costs | Employment |
| 514X | Other Costs of Employment | Employment |
| 515X | Salaries | Employment |
| 516X | Non-Industrial Expenses | Employment |
| 517X | Temporary Support Staff | Employment |
| 611X | Cost Reallocations | Employment |
| 612X | N/A | Employment |
| 613X | N/A | Employment |
| 614X | N/A | Employment |
| 521X | Power | Power |
| 531X | Operational Contractors | Hired and Contracted |
| 532X | Other Contractors | Hired and Contracted |
| 534X | Out sourcing | Hired and Contracted |
| 538X | Consultants Fees | Hired and Contracted |
| 541X | Materials and Equipment | Materials & consumables |
| 544X | Non Operations Materials | Materials & consumables |
| 547X | Stock Adjustments | Materials & consumables |
| 548X | Chemicals | Materials & consumables |
| 536X | Office and Computer Services | other direct costs |
| 537X | Legal and other professional fees | other direct costs |
| 551X | Accommodation | other direct costs |
| 553X | Insurance - Premiums | other direct costs |
| 553Y | Insurance - Claims | other direct costs |
| 554X | Public Liability | other direct costs |
| 555X | Employer's Liability | other direct costs |
| 616X | N/A | other direct costs |
| 695X | Management Task | other direct costs |
| 759X | Overheads Capitalised | other direct costs |
| 518X | Staff Training & Hospitality | General & support |
| 533X | V&P repairs | General & support |
| 539X | Audit | General & support |
| 546X | Mobile V&P Charges | General & support |
| 552X | Communication | General & support |
| 556X | Other Grants and Subscriptions | General & support |
| 557X | Advertising and Publicity | General & support |
| 641X | Intra Departmental Notionals | General & support |
| 651X | Inter Departmental Notionals | General & support |
| 772X | Bad Debts | Doubtful debts |
| 775X | Discount Allowed | Customer services |
| 558X | Rates | Rates |
| 556Y | Regulatory Costs | Other Business Activities |
| 534Y | PPP | PPP unitary charge |

Responsibility Codes

The Company advised that all cost centres within the general ledger system have responsibility codes associated with them. Thus all transactions within the system have responsibility codes assigned. Responsibility codes relate individual cost centres to individual employees within NI Water. These employees are responsible for the cost centre. Common costs which cannot be easily split using the expense and service activity codes are split on the basis of responsibility codes. This includes customer services, scientific services and other business activities (regulatory costs) spend.

Responsibility codes are structured into directorates. Each directorate has separate areas of responsibility within the Company. We challenged the Company previously in relation to whether management responsibility is clearly defined and specific to customer services, scientific services and other business activities and whether the schemes assigned to them were truly specific to that service area. The company advised that all costs in the GL were coded to an appropriate manager and all managers could be mapped to service areas for the purposes of reporting data for customer services, scientific services and other business activities.

The Company confirmed that the personnel department are advised immediately after an individual receives revised responsibilities or job specification.

We believe that the above method could impact on the robustness of data reported. Nevertheless in the absence of other information the process followed is appropriate to split expenditure between service types (water and sewerage) and we believe will give an overall allocation of costs that is broadly reflective of the actual position.

4.3 Cost to Serve Project

The cost to serve project continues to be implemented. Although it still has some way to go before completion it now provides a greater degree of cost allocation to individual activities. Individual jobs are now automatically mapped to codes that allow for the reporting of expenditure in the AIR tables. The Company considers that the full implementation of the cost to serve project may still take a few years. The Company considers the cost to serve project will be implemented in three stages. These are 1) Provide cost data, 2) Understand cost data; 3) Drive costs down. The Company is still at the first stage of collection of data and refinements of this data.

4.4 Allocations by Line (NI Water)

Employment Costs

The process relies on the completion of timesheets that use a mix of service activity and expense code for direct operations staff. For non-direct operations staff, expenditure is assigned on the basis of responsibility codes. For AIR11 the Company included Vehicle Plant and Charges under employment costs. This

amounts to £1.8 million in total across water and sewerage. NI Water advised that this continues to be included in Employment Costs in AIR12. Further, any redundancies are included in line 1. NI Water has incurred circa £2.9 million worth of voluntary redundancy costs of which circa £2.1 million related to a voluntary severance scheme.

Remaining Direct Costs

The process relies on the correct coding of invoices to a mixture of service activity codes and expense codes. Further information on this process is provided below.

General and Support expenditure

The coding does not allow for the direct coding of General and Support expenditure in all cases. For example, service activity 390 relates to network activities for both water and sewerage.

For the Report Year, general and support costs have been split on the following basis:

| Allocation of General and Support | Water | | Sewerage | | | Comments |
|-----------------------------------|-------|--------------|----------|------------------|-------------------------|---|
| | R&T | Distribution | Sewerage | Sewage Treatment | Sludge Treatment & Disp | |
| G&S Overhead Pot 1 | 25.4% | 26.5% | 18.1% | 21.2% | 8.8% | Non ops general spend. Excludes CS, SS & Regulation |
| G&S Overhead Pot 2a - Water | 49.0% | 51.0% | 0.0% | 0.0% | 0.0% | Water related activities only |
| G&S Overhead Pot 2b - Sewerage | 0.0% | 0.0% | 37.6% | 44.1% | 18.3% | Sewerage activities only |
| G&S Overhead Pot 3 | 25.4% | 26.5% | 18.1% | 21.2% | 8.8% | Water and sewerage networks spend only |

The percentages are broadly similar to previous years.

The total value of general and support costs allocated at the time of our audit was in the region of £38 million. The split of costs between the different pots is show below:

- Overhead pot 1 relates to non-specific General and Support costs. These have been split across the services on the basis of calculated total direct costs.
- Overhead Pot 2a and 2b relate to overheads for water and sewerage spend. These costs have been pro-rated on the basis of total direct costs within each of water and sewerage cost categories.
- Overhead Pot 3 relates specifically to networks functions activity. Again, the company has split across the services on the basis of total direct costs. As these overheads relate specifically to network activities it may be more appropriate to split this expenditure against distribution and sewerage.

The more detailed split from the Company commentary on general and support costs for AIR 12 is provided below:

| Description | Amount – 2011/12 | Amount – 2010/11 | Difference |
|--|------------------|----------------------|---------------|
| Unallocated Employment Costs | £20.5M | £22.9M | -£2.4M |
| Unallocated Power | £0.0M | £0.0M | £0.0M |
| Unallocated Hired & Contracted Costs | £6.3M | £10.5M | -£4.2M |
| Unallocated Materials & Consumables | £1.5M | £1.6M | -£0.1M |
| Unallocated Other Direct Costs | £3.7M | 7.0M | -£3.3M |
| Communication | £1.1M | £1.0M | £0.1M |
| Mobile V&P Charges & Repairs | £2.3M | £2.3M | £0.0M |
| Audit & Environmental Regulatory Costs | £1.8M | £1.8M | £0.0M |
| Other | £0.6M | £0.3M | £0.3M |
| Total | £37.8M | £47.4.million | -£9.6M |

In total this shows a circa £10 million reduction in G&S costs compared to AIR11. The largest variances are Unallocated Employment Costs, Unallocated Hired and Contracted Costs and Unallocated Other Direct Costs. The Company commentary fails to discuss the reasons for this variance in detail. We have challenged NI Water about the reasons for the variation. NI Water advised:

“The G&S reduction of £9.6M from AIR11 to AIR12 is mainly due to:

- Employment costs – the reason for the reduction is due to a reduction in staff numbers from AIR11; decrease in overtime costs (unusually high overtime costs in AIR11 due to the Freeze Thaw major incident) and a reduction in temporary support staff.
- Hired and Contracted Services costs – the release of a provision to provide for costs incurred by other departmental bodies for the Freeze Thaw; a reduction in accommodation costs due to the rationalisation of NI Water offices and a reduction in spend on consultants.
- Other Direct Costs – the reduction is as a result of a significant number of retro EL and PL claims settled in 2011/12 for amounts less than anticipated”.

Our analysis shows that N Water is only second to [x] in relation to general and support costs as a proportion of total direct costs when compared to other WASCs.

Operating Expenditure

In order to split common costs between water and sewerage the following split has been used:

| | Water | Sewerage | Total |
|---------------------------|--|----------|--------|
| Customer Services | 51.9% | 48.1% | 100.0% |
| Scientific Services | 51.9% | 48.1% | 100.0% |
| Other Business Activities | 51.9% | 48.1% | 100.0% |
| Rates | 54.1% | 45.9% | 100.0% |
| Doubtful Debts | Split on basis of management judgement | | |
| Third Party expenses | 100.0% | 0.0% | 100.0% |

The 51.9% - 48.1% split above is based on total direct costs between water and sewerage.

The split for rates is based on actual invoices.

Third party expenses are based on actual costs coded to cost centres.

We believe the approach to apportion expenditure described above is appropriate.

The Company has made a number an adjustment for the bad debt provision for AIR12. In short NI Water believes that a proportion of the old debt will not be written off as bad debt but will be removed via negative system adjustments. In effect NI Water believes the reduction will be in income rather than in debt expense.

NI Water estimated a future adjustment of 7% and 15%. This resulted in a reduction of debtors by £2.2 million. The data reported in this table relates to that reduced expected value of debt. We queried with NI Water whether this means that it was not in fact owed this £2.2 million due to system overcharging. If it was indeed owed that £2.2 million then why is it writing off monies that are owed to NI Water? The Company advised:

'The Company has made an adjustment to debtors in AIR 12 which impact on the bad debt provision. In short NI Water believes that a proportion of the old debt will not be written off as bad debt but will be removed via future negative system adjustments. In effect NI Water believes the reduction will be in income rather than in debt expenses. NI Water has estimated that a future adjustment of debtors of water: 7% and sewerage: 15%. This has resulted in a reduction of debtors by £2.2 million which has in turn reduced the bad debt provision by £1m. This £1m is reflected in the data in these tables.

The overall reduction of £3.1m from AIR 11 can be explained as follows:

| | |
|--|-----|
| | £m |
| AIR 12 Reduction in bad debt provision arising from £2.2m adjustment | 1.0 |
| AIR 12 Reduction in specific industry bad debt provision | 0.4 |
| AIR 11 one off increase in specific industry bad debt provision | 1.1 |
| AIR 11 one off legacy debt written off | 0.6 |
| Total reduction | 3.1 |

It should be noted that the £2.2m adjustment has not impacted the underlying debtors ledger i.e. it has not been written off. The full gross debt will continue to be pursued to recovery and only reduced where the Company is satisfied that customers have been overcharged or an allowance is due.'

Customer Services

The identification of customer services costs relies on the correct coding of invoices and the appropriateness of responsibility codes for service activities. In order to report this data the company considers responsibility codes and assigns costs to customer services based on these responsibility codes.

Scientific Services

As for customer services, the process relies on the correct coding of invoices and the appropriateness of responsibility codes for service activities.

Other business activities

In order to report this data, the Company uses responsibility codes.

Rates

The Company advised that the value for rates is based on actual rates bills combined with accruals on a site by site basis. This enables the charges to be split on a site by site basis.

Doubtful Debts

The basis of the split of doubtful debts is described above.

Exceptional Items

The Company has not reported any exceptional items. A number of items have been recorded as atypical. These are discussed below in section 4.6.

Third Party Service - Opex

As for other costs reported, the process relies on the correct coding of invoices.

Total PPP Unitary Charges

[x]

Reactive and Planned Maintenance Infrastructure

As for other costs reported, the process relies on the correct coding of invoices.

Reactive and Planned Maintenance Non-Infrastructure

As for other costs reported, the process relies on the correct coding of invoices.

4.5 Allocation of costs to un-appointed activities

The Company advised that these activities are either charged on a full cost recovery basis (and thus costs broadly mirror the income generated), or the income does not give rise to any additional operational costs (e.g. rents received or fishing rights). The Company advised that this is consistent with the basis of the historic returns.

4.6 Atypical Costs

Reorganisation costs

The Company has reported a total of £4.4 million reorganisation costs. These are split between the business improvement programme (£1.5million) and Voluntary Severance / Early Retirement Scheme (£2.9 million).

Freeze Thaw Incident

The Company has released some provision it made to deal with outstanding issues on the Freeze Thaw which did not materialise. The Company advised that this is responsible for the significant swing in Opex costs compared to previous years.

4.7 Fines and Donations

NRSWA Fines

The Company has not made any comment in its commentary related to fines. However, the company advised that it has not had any such fines for the report year.

Donations to charitable trusts or other funds assisting customers with payment difficulty

The Company has not reported any donations to charitable funds for the Report Year.

4.8 Exceptional Items

The company has not reported any exceptional items for 2011/12. Atypical items are listed above.

5. Table 21 Specific Lines

The Commentary below compares the AIR12 reported data with AIR11.

5.1 A – Direct Costs

Line 1 – The small increase here is attributed primarily to the VER costs. We note they have increased in total by £0.3 million in nominal terms.

Line 2 – There has been a general reduction in power costs across all categories. This is due to mostly the cessation of a fixed price contract for the supply of electricity. Although the contract ceased in September 2010 the full year benefits have only just been realised. This has been offset by the CRC energy efficiency scheme of £0.9 million.

Line 3 – The Company has not reported any costs in relation to Agencies.

Line 4 – There has been an overall reduction in water distribution of 24%. This is primarily due to the one off costs in AIR11 for the freeze thaw which have

not been repeated for AIR12.

Line 5 – As last year the Company has reported zero costs.

Line 6 – There has been a 34% reduction in materials and consumables in water distribution for AIR12. In nominal terms this relates to less than £0.3 million.

Line 7 – The Company has not reported any costs in this line.

Line 8 – The Company has not reported any costs in this line.

Line 9 – The values in this line are not material.

Line 10 – This is the sum of lines 1 to 9.

Line 11 – General and support expenditure has reduced significantly from AIR11. General and support costs are coded to specific cost centres and are split between water and sewerage based on total direct costs. The reason for the reduction is discussed above under general and support expenditure heading.

Line 12 – This is a calculated line. This is the sum of direct costs and general and support expenditure reported above.

5.2 B - Operating Expenditure

Line 13 – These costs related to customer services. They have increased in nominal terms by £1 million. The reason for the increase is attributed to insourcing the accounts service function from Echo. In addition customer services costs have been impacted by a change in the percentage split of costs between water and sewerage compared to AIR11.

Line 14 – Scientific services have only changed marginally from the values used historically to make these splits. In addition scientific services have been impacted by the changed percentage cost allocation.

Line 15 – Other Business Activities have only changed marginally from the values used historically to make these splits. In addition Other Business Activities have been impacted by the changed percentage cost allocation.

Line 16 – This is a calculated line.

Line 17 – The values have increased in line with the increase in rates. The data is taken primarily from actual invoices.

Line 18 – The approach taken to doubtful debts is described above, which has resulted in these adjustments.

Line 19 – NI Water has reported zero in line 19.

Line 20 – This is a calculated line.

Line 21 – These costs are relative immaterial. NI Water has advised they have reduced due to a change in the accounting treatment of such costs.

Line 21a – NI Water has reported [x] under this line.

Line 22 – This is a calculated line.

5.3 C - Reactive & Planned Maintenance

Line 23 – This line relates to infrastructure maintenance. There has been a marginal change in this figure compared to the previous year. The Company has not provided any detail behind why this figure has changed from the previous year.

Line 24 – This line relates to non-infrastructure maintenance. There has been a marginal change in this figure compared to the previous year. The Company has not provided any detail behind why this figure has changed from the previous year.

6. Table 22 Specific Lines

6.1 A – Direct Costs

The commentary below compares the AIR12 reported data with AIR11.

Line 1 – NI Water has reported only a marginal variance on employment costs compared to AIR11.

Line 2 – The Company has reported a net reduction in sewerage power costs of £0.3 million. This is made up as follows:

- -£1.4 million due to a reduction in electricity costs. This reduction has been driven by the cessation of the fixed price contract back in September 2010, and is only now showing the full year saving;
- An increase of £1.3 million from the Carbon Reduction Commitment Energy Efficiency Scheme of £1.1 million.

On power costs the field managers provide a percentage estimate of power costs between Sewage Treatment and Sludge Treatment at each of the works where there are both activities. This approach is the same as that used for AIR11. For AIR13 we will check the rationale of this split and provide comment.

Similarly the Duncrue Street treatment works has one meter, whilst it

provides for both Waste Water Treatment and Sludge Incineration. Again the split used is based on management judgement. We will review the basis of this split in more detail during our audit of the AIR13 programme.

Line 3 – The Company has not reported any costs in relation to Agencies.

Line 4 – For AIR12 the net impact is an increase in costs of £0.8 million. This is made up of the following:

- £0.9 million increase in Sewage Treatment, attributed primarily to MBR cleaning;
- £0.5 million increase in Sludge Treatment and Disposal, attributed primarily to an increase in fuel prices;
- a £0.7 million reduction in sewerage, impacted by the release of an accrual.

Line 5 – The Company has not reported any costs for associated companies.

Line 6 – Materials and consumables have been impacted marginally between AIR11 and AIR12.

Line 7 – The Company has not reported any costs in this line.

Line 8 – There has only been a marginal change in this data between AIR11 and AIR12.

Line 9 – This is a calculated line.

Line 10 – There has been a reduction in general and support costs of £3million. General and Support costs have reduced overall between the two years. The overall movement in general and support costs is discussed above.

Line 11 – This is a calculated line.

6.2 B - Operating Expenditure

Line 12 – The Company advised that customer services costs have increased by £1million compared to AIR11. [

x

]

Line 13 – Line 13 relates to scientific services costs. There has been a marginal increase. Costs are split between water and sewerage on an equivalent basis to that described under line 12 above for water.

Line 14 – the Company has advised that the following cost categories exist for ‘other business activities’:

- Utility Regulator Fees;
- NI Water staff working within the regulatory function;
- Reporter costs

NI Water advised that the AIR11 figures included some provision for the Freeze Thaw incident. This partly explains the reason for the reduction of £0.3m in this category.

Line 15 – This is a calculated line. It is the total of Lines 13, 14 and 15.

Line 16 – This relates to local authority rates. NI Water advised that these have increased from AIR11. NI Water advised that this reflects the large credit recovered in 2010/11 for waste water treatment works included in AIR11.

Line 17 – Doubtful debts have reduced to a credit position. We have challenged NI Water in relation to this data.

Line 18 – The Company has reported zero in line 18 for exceptional items.

Line 19 – This is a calculated line.

Line 20 - There has been no material change in this line between the two years.

Line 20a – NI Water has applied a nominal figure of [x] in this line.

Line 21 – Line 21 is total operating expenditure. This is a calculated line.

Line 21a – NI Water has reported [x] in this line.

6.3 C - Reactive & Planned Maintenance

Line 22 – This line relates to infrastructure maintenance. There has been a marginal reduction of £0.6m in this line.

Line 23 – This line relates to non-infrastructure maintenance. There has been a reduction of £0.5m in the Report Year.

7. Infrastructure Renewals Charge (IRC)

See commentary for Table 33.

8. PPP Data Tables

8.1 General

For AIR12 all PPP facilities are online and have continued to operate for the full year. The Kinnegar contract has been providing services for a number of years. The sites at Alpha were all fully operational prior to AIR11. The Omega contracts are all now fully operational as well. The Duncrue site became operational on the 31st March 2010. Omega consists of 2 sludge services sites and 5 sewerage sites as well as a sludge remediation site.

8.2 Methodology (PPP)

The Company advised that it has sought to obtain data on a 'best endeavours' basis. However, not all the PPP contractors are obliged to report data to the regulator. NI Water advised that:

- The Kinnegar contract was designed in the 1990s. It was designed prior to any consideration for a Go-Co. As a result, no clause exists for the provision of regulatory information. In addition it should be noted that the contractor for Kinnegar is responsible for all operating expenditure, including electricity;
- For the Alpha contract there is an implicit requirement to provide this information. The Company advise that any information requirements are discussed in relation to whether or not it falls within the scope of the contract, but that the contractor is very supportive and co-operates with almost all of the regulatory information requests;
- For the Omega contract the obligation for regulatory reporting data is explicit. The Company advised that the contractor has been supportive in any requests for information that have been made.

8.3.1 Table 21 – Specific Lines

Line 2 – The power costs here relate to water resources and treatment for the Alpha contract. The Alpha contract only provides potable water. Costs have reduced by circa [$\quad \times \quad$]

Line 9 – No costs have been incurred in the Report Year.

Line 11 – There has been a marginal reduction in the general and support costs compared to AIR11.

The analysis is based on an assessment by the company of the number of staff employed within the PPP contract administration function. Not all staff are employed full time on PPP related activities. The Company analysis

relies on management judgement of where to allocate payroll costs of staff. We believe it is a simplification. However, in the absence of direct timesheet data we consider this to be an appropriate method of apportioning these costs. In addition any consulting costs incurred for this contract are included here.

Line 14 – No net costs are incurred for scientific services.

Line 17 – There has been a slight reduction in the rates cost compared to AIR11 due to an accrual release in AIR10. Rates are up in AIR12 from AIR11.

Line 21a – [

x

]

Line 22a – [

x

]

8.3.2 Table 22 – Specific Lines

Line 2 – The Company reports a 10% increase in these costs mainly due to the Carbon Reduction Commitment.

Kinnegar pays its own electricity bill and hence the inclusion of costs for Kinnegar here would result in double counting. The Company has therefore not included or tried to estimate the Kinnegar electricity cost. The Company advised that it has no basis for estimating these costs.

Line 10 – There has been an overall marginal increase in General and Support costs. The Company reports a total value of £257k compared to £206k reported in AIR11. The analysis is based on an assessment by the Company of the number of staff employed within the PPP contract administration function. Not all staff are employed full time on PPP related activities. The Company analysis relies on management judgement of where to allocate payroll costs of staff. We believe it is a simplification. However, in the absence of direct timesheet data we believe this an appropriate method of apportioning these costs. In addition, any consulting costs incurred for this contract are included here.

Line 13 – For the Report Year the Company advised that it had provided a number of tests as contractually obliged under the Omega and Kinnegar contracts. This included tests related to suspended solids and determination of oxygen demand for processes. The overall variance is negligible.

Line 16 – Rates costs of £0.952m have been reported for PPP for the current year. This is based on the actual rates bill which can be identified by site. Some apportionment was required to allocate the expenditure for the Duncrue site.

Line 20a – [x]

Line 21a – [x]

Date: 25 July 2012
Prepared By: HMS

Table 25 - Analysis of fixed assets by asset type**Commentary by REPORTER****1. Key Findings**

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 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.

The basis of the accounting used for regulatory purposes splits infrastructure and non-infrastructure assets, dealing with non-infrastructure assets primarily through the RAB and the depreciation charge, and dealing with infrastructure assets primarily by means of the Infrastructure Renewals Charge. On this basis we would have thought that any changes in the values of existing infrastructure assets should be included in line 2 as revised MEAV values, rather than be reported under cells that are generally reserved for operational and tangible assets.

Nevertheless we understand from NI Water that the Auditor believes the approach followed is the correct one.

Date: 25 July 2012
Prepared By: HMS