

COMMERCIAL IN CONFIDENCE

Chapters 30 & 31

Transactions with Associated Companies

Covering:
Capex
Profit and loss charges

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Transactions with Associated Companies

Introduction

The reporting requirements set down the information the Appointee is expected to provide. This will enable the auditors' report to focus on the Appointee's degree of compliance with RAG 5.04. This should remove unnecessary correspondence with companies following the return and minimise queries.

These tables cover capital and profit and loss expenditure transactions with associate companies, in accordance with RAG 5.04, Transfer pricing in the water industry. This information, both data and commentaries, is collected on a Commercial in Confidence basis.

These tables each have three blocks. The blocks are in a flexible format to allow companies to include information for each associate with which the company has transactions. Companies may add up to 98 entries in each block; exceptionally, if a company wishes to make more than 98 entries in any one block, the additional entries should be recorded in the commentary.

An **associated company** should be determined in accordance with 'Financial Reporting Standard (FRS) 8, Related Party Disclosures' as modified in Ofwat **Dear Regulatory Director** letter RD 29/97. When FRS 8 is superseded by a standard consistent with International Accounting Standard 24 (IAS 24), as proposed in Financial Reporting Exposure Draft 25 (FRED 25), NIAUR will take a consistent approach to determining related parties and necessary disclosures. NIAUR's view is that the existence of any common shareholding, regardless of the level which may distinguish between control and the ability to exert influence, defines a related party. Any exceptions to this should be agreed with NIAUR.

Entries in the tables should consist solely of actual capital and profit and loss expenditure made by the Appointed business to an associate company for the direct provision of supplies, works or services. For the avoidance of doubt, this should include all costs that are passed through to third parties. The value of the pass through costs should be included in the commentary.

Loans, capital, issues or redemptions, dividends, transfers of land and properties and recharges to associates, should not be included in the table. Such transactions should be identified in the commentary to the table.

Any single transactions which exceed the greater of £100,000 or 0.5% of the Appointee's turnover should be recorded on a separate line in the table. Any transaction that is not individually material, i.e. less than £100,000 or 0.5% of the Appointee's turnover, should be aggregated by associate and recorded on a separate line in the table.

Column definitions

Col 1: Associate: the name of the Associated company.

Col 2: Description: details of the service provided categorised by the method of market testing employed. In deciding how to allocate services to the appropriate market testing method employed, the following definitions should be used:

- **Competitive letting** – where an associate successfully wins a contract in competition with a number of third parties;

- **Other market testing** – to include supplies, works or services that have been subject to a form of market testing such as benchmarking, third party evaluation or comparison to list prices (where these have been sought expressly for this purpose); the method used should be stated in the commentary; or
- **No market** – where no market exists for the provision of supplies, works or services and prices are based on cost.

Col 3: Nr (0 dp): the number of transactions undertaken with the named associate.

Col 4: £000 (0 dp): the value of transactions (in thousands of pounds) undertaken with the named associate.

Col 5: Percentage of total (0 dp): the value of transactions with this associate expressed as a percentage of the total capital expenditure made with associates.

Totals lines

Each cell in the sub-totals lines is calculated from the preceding lines in each section. The grand total (line 300) is calculated from each of the sub-total lines.

Nr (0 dp): the total number of capital expenditure transactions undertaken by all associates; the sum of all the lines in this column.

£000 (0 dp): the total value of transactions undertaken by associates; the sum of all the lines in this column.

Percentage of total (0 dp): this line is calculated as the sum of all the lines in this column. It should equal 100%.

Primary purpose

All lines in Tables 30 and 31 are allocated the primary purpose “Checking compliance with statutory and Licence requirements”.

Commentary to Tables 30 and 31

Licence Condition F requires Appointees to trade at arm’s length from associate companies, to ensure that no cross-subsidy occurs. To demonstrate that this condition has been met, Appointees have a duty to provide NIAUR with information on transactions that have taken place between the Appointed business and associate companies.

Appointees should have policies and procedures governing the procurement of supplies, works and services which comply with the principles of RAG 5.04. Appointees should put in place systems that enable all transactions with associate companies to be recorded and reported in line with the requirements set out below.

Appointees will be expected to provide the following information with the Annual Information return each financial year:

1. A statement of compliance that the Appointee has complied with Condition F of its Licence;
2. A declaration by the Directors and senior managers of the Appointee of interests in associates with whom the Appointee trades;
3. Details on procedures used to award the contracts to associates which are declared in Tables 30 and 31;

4. Details on transactions with associates other than for the direct provision of supplies, works or services to the Appointee.

Details of these four key requirements are set out below:

1. The Directors of the Appointed business should state that the Appointee complies with the objectives and principles of RAG 5.04, namely that transactions with associate companies are at arm's length and that cross subsidy is not occurring;
2. The Directors of the Appointed business should accompany their declaration of interests with a statement that no director has acted as both purchaser and supplier in any transaction with an associate company. The Appointee should give a description of procedures that it has put in place to ensure that conflicts of interest do not occur;
3. For transactions with associate companies, the Appointee should set out the following information in the relevant chapters of the return: chapter 30 should be used to record capital expenditure and chapter 31 should include profit and loss expenditure.

For each contract in excess of 1% of the Appointed business turnover the following details should be provided in the commentary to Table 30 & 31. Also where the aggregate value of trade with an associate represents more than 50% of the associate's turnover, but individual contracts are less than 1% of the Appointed business turnover, the following details should be provided for a sample number of contracts:

- The value of supplies, works or services supplied in the current year;
- The total value of the contract. Any significant variations between the anticipated contract value and actual expenditure should be explained;
- The date when the contract began and the date when it is due to expire. Any options to extend or terminate that were included in the original contract should be recorded;
- Details of the advertisement of the contract;
- The method of selection that was used to award the contract;
- Where other market testing was used, state who conducted the evaluation or benchmarking, the method and the number of comparators used;
- When the contract was advertised and the number of parties which expressed an interest;
- The number of companies that were invited to submit a tender and the basis for their selection;
- The number of tenders that were submitted and the number and basis for those tenders which were excluded or withdrawn;
- The number of tenders that were evaluated and the method used, including details where applicable of the tender evaluation score sheet or other similar matrices. This should demonstrate that all tenders were evaluated on a consistent basis;
- The outcome of negotiations undertaken with interested parties; and
- The reason for the award of the contract.

For those contracts not covered above, the following details should be provided. Please provide this commentary by reference to line numbers in table 30 & 31.

- The value of supplies, works or services supplied in the current year;
- The procurement policy used and the number of tenders received and rejected. Where other market testing was used state the method and number of comparators used; and
- The rationale for the selection of the successful party, including the basis of the tender evaluation.

The commentary should also include the overall value of transactions with each individual associate and that associate's turnover as required by Licence Condition F6.5.

4. The commentary to the return should provide details on the following transactions with associate companies. None of the information described below should be included in the tables:
- Income received from Associates or recharges made by the Appointee where it supplies goods, services or supplies to associates, e.g. accommodation, IT services, personnel services, etc. This should also be recorded as non-appointed income in the Regulatory Accounts where it is in excess of the thresholds for reporting;
 - Indirect transactions with associates via a third party should be reported in the commentary to tables 30 and 31. The commentary should record the value of such transactions, the associates involved and whether or not the associate was nominated as a sub-contractor. All transactions involving a nominated associate should be recorded. Where it is not possible to include details of associates sub-contracted to the Appointee, an explanation should be provided. Appointees should provide proposals to NIAUR of any materiality levels that they consider to be appropriate to the recording of this information;
 - All transfers of assets, land or property that took place within the financial year should be recorded in the commentary. Any significant difference between 'fair market price' or net book value, and the price at which assets are transferred should be recorded;
 - Details of loans, capital, issues or redemptions and dividends should be recorded, in the commentary to table 31 where they relate to trade between the Appointee and associate companies;
 - A statement of turnover for associates with whom the Appointee has traded. A summary of the total transactions, by associate, between the Appointee and associates and details of the percentage of the associate's turnover that this represents; and
 - The commentary should describe the terms of any partnering arrangements that exist between the Appointee and associate companies. This should set out the method used to select the Partner; the period of time for which it will run; and mutually agreed and reasonable targets for improving performance and reducing costs.

If the Appointed business is unable to provide any of the information above, it should make this, and the reasons for not providing the information, clear in the commentary. For each of the requirements that do not apply to the company, a 'nil return' should be included.

Please provide a current tree diagram showing all the companies within the Group (excluding those that are dormant). The diagram should also show the relationship between subsidiaries and their holding companies, including joint ventures and other trading or financial relationships. Please annotate the diagram with the percentage of shareholdings.

5. Where the Company has no associated companies it should declare this to be the case in commentary and submit a nil return.

CHANGE CONTROL SHEET

CHAPTER 30 & 31

2008/1.0	First issue of chapter for the SBP period