Northern Ireland Water Limited

Auditors' Report and Commentary on the Annual Information Return

Year ended 31 March 2010

Notice about this report

This report is made solely to the Board of Directors of Northern Ireland Water Limited and to the Northern Ireland Authority for Utility Regulation in accordance with our engagement letter dated 7 May 2009. Our work has been undertaken so that we might state to the Board of Directors of Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation those matters we are required to state to them in this report and for no other purpose. To the fullest extent permissible by law we do not accept or assume responsibility to anyone other than a Board of Directors of Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation for our work, this report or for the opinions we have formed.

19 July 2010
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1 Notice about this report

1.1.1 This report is made to NIWL and NIAUR in accordance with the terms of our engagement dated 7 May 2009.

1.1.2 This report is confidential and has been prepared solely for the purpose of Northern Ireland Water Limited (‘NIWL’) and The Northern Ireland Authority for Utility Regulation (‘NIAUR’) (the Beneficiaries), and has been released to the Beneficiaries on the basis that it will not be copied or disclosed to any third party or otherwise quoted or referred to, in whole or in part, without our written prior consent.

1.1.3 This report is not suitable to be relied on by any party wishing to acquire rights against KPMG (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtain access to this report or a copy (under the Freedom of Information Act 2000 or otherwise) and chooses to rely on this report (or any part of it) does so at their own risk. To the fullest extent permitted by law, KPMG does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

1.1.4 The contents of the report should not be taken as reflecting the views of KPMG except where explicitly stated as being so.

1.1.5 To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with management and directors of the Company. Except to the extent necessary for the purposes of the audit, this information has not been independently verified.

1.1.6 This report refers to Northern Ireland Water Limited as ‘NIWL’ and makes references to ‘Oracle’, ‘Rapid Xtra’, ‘CIDA’ and ‘Echo’. Oracle is the accounting system used by NIWL, Rapid Xtra is the billing system and CIDA is the capital investment driver allocation system. Echo has been subcontracted to provide billing, credit management and customer services to NIWL.

1.1.7 The Statutory Accounts for the year ended 31 March 2010 were approved by the Board of Directors and signed on 29 June 2010. The Regulatory Accounts for the year ended 31 March 2010 were approved by the Board of Directors and signed on 29 June 2010.

1.1.8 This report should be read in conjunction with the Annual Information Return prepared by NIWL for the year ended 31 March 2010**.**

1.1.9 Where no guidance has been given to auditors, we have assumed that comment is not required on these tables and have therefore not included these within the scope of our work.

2 Report of the Independent Auditors to Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation

We have reviewed the Regulatory Accounts tables 6a, 18 to 31, 33, 34, 39, 42 and 43 set out in the Annual Information Return in respect of Northern Ireland Water Limited ("the Company").

This report is made to the Company in accordance with the terms of our engagement letter dated 7 May 2009 (the "Contract"). This report is made also to the Northern Ireland Authority for Utility Regulation ("NIAUR") in order to meet the requirements of the Instrument of Appointment by the Department for Regional Development of Northern Ireland Water Limited as a water and sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006 (the "Regulatory Licence") and to enable the NIAUR to verify that a report from independent auditors has been issued in connection with the Regulatory Accounts tables 6a, 18 to 31, 33, 34, 39, 42 and 43. Our work has been undertaken so that we might state to the Company and to the NIAUR those matters we have been engaged by the Company to state in this report and for no other purpose.

This report has been released to the Company and to the NIAUR on the basis that it shall not be copied, referred to or disclosed, in whole (save for the Company's or the NIAUR's own internal purposes) or in part, without our prior written consent. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our work, for this report, or for the opinions we have formed. We will accept such responsibility to the NIAUR on condition that the NIAUR agrees in writing to the Contract by signing the notice appended to the Contract.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of the Regulatory Accounts tables.

Our responsibilities, as independent auditors, are established in the United Kingdom by relevant legal and regulatory requirements, the Contract and the Accounting Guidelines and other relevant material issued by the NIAUR. It is our responsibility to form an independent opinion based on our review, on those tables and to report our opinion to the Company and (on the basis set out above) to the NIAUR.

Basis of opinion

We conducted our review in accordance with the Regulatory Accounting Guidelines, the Annual Information Return reporting requirements dated March 2010 and other relevant material issued by the NIAUR and the Contract. A review includes examination, on a test basis, of evidence relating to the amounts and disclosures in the Regulatory Accounts tables. It also includes an assessment of the significant estimates and judgments made by the Company's directors in the preparation of the Regulatory Accounts tables, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts tables are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the Regulatory Accounts tables in terms of UK Generally Accepted Accounting Principles and the Regulatory Accounting Guidelines.

Opinion

Based upon our view, in our opinion, the Regulatory Accounts tables contain the information for the year to 31 March 2010 required to be submitted to the NIAUR by the Company to comply with Condition F of the Regulatory Licence and are materially consistent with the information submitted to NIAUR in the Regulatory Accounts.

KPMG
Chartered Accountants
Belfast
19 July 2010

3 Part A – General Procedures

Requirement (followed by our commentary for each procedure listed)

3.1 From discussions with management and sight of underlying documentation, describe the NI Water's sign off procedures. Describe the nature of the underlying documentation observed.

3.1.1 Whilst we recognize the improvements made since the prior year in the current system and process for the production and review of information contained in the Annual Information Return (AIR) we note that further refinements could be made. Currently each table is assigned an owner within the Finance and Regulation Directorate (FRD) with some of the more complex tables having an owner assigned to each line. In cases where lines have been assigned to different owners we consider that the administrative burden of ensuring that all amendments have been reflected in the final tables may lead to an increased risk of error. We recommend that each table is assigned to one individual wherever possible.

3.1.2 Each table or line owner is responsible for populating the table (and associated company commentary) with the relevant data in line with the relevant guidance from the Northern Ireland Authority for Utility Regulation (NIAUR). A separate member of the FRD was then required to review each table and ensure the completeness and accuracy of the information contained within. Once reviewed and the required changes made both the preparer and reviewer signed the assurance statement which stated the table was in accordance with the regulatory guidance. An appropriate member of the senior management team was also required to sign the assurance statement approving the table and commentary for inclusion in the AIR 2010 submission.

3.1.3 The table (and associated company commentary) and the assurance statement were then both submitted to the holder of the 'master copy' of the AIR for final formatting changes and preparation for submission to the Utility Regulator ("NIAUR").

3.1.4 On 2 July 2010, the Board approved the text of the AIR 2010's Board overview and agreed submission of all final AIR10 tables and commentaries to the Utility Regulator. This ensured consistency of approach.

3.2 For each Regulatory Table*, check that NI Water has complied with Definitions Manual or has included a commentary as to why the guidance has not been followed.

we have considered only those tables on which we are required to report – as set out in the Auditors' report on pages 2 and 3

3.2.1 For each of the tables/elements of tables where the Auditors' had specific responsibilities (as referred to in Sections B – J of the Auditors' guidance, and reported on in our Auditors' Report (tables 6a, 18 to 31, 33, 34, 39, 42 and 43), we carried out procedures to satisfy ourselves that the requirements of the guidance had been complied with. We noted the following exceptions:

3.2.2 **Part A General Procedures**

No issues noted.

3.2.3 **Part B Activity Cost Analysis**

In AIR 10 there has been a change in the methodology for identifying direct costs and general and support costs. Detail of the change in methodology is contained at 4.3.1. As a result of the change in methodology management have prepared restated AIR 09 figures and these form the basis of the commentary for Tables 21 and 22. Sample checks were not carried out on the restated tables however we have discussed the process with management by which the comparatives were restated to ensure that the comparison provided by management in their commentary was accurate. Management have referred to this change in methodology in their commentary.

3.2.4 **Part C Pensions**

The Company has not carried out an exercise to separately analyse staff members included in the Pension Scheme between those involved in Appointed and Non-Appointed activities, and consequently have not analysed the pension asset or the associated net interest cost between Appointed and Non-Appointed activities. Management have provided full explanation in their commentary to Tables 21 and 22 and believe the cost of calculating the impact for these members in isolation to be unjustified. We recommend that management take actions to identify those staff members, and hence costs, attributable to non-appointed activities and ensure that these are reflected in their cost allocation. Management note in their commentary that in the process of apportioning costs (including total wages, salaries and pensions) to unappointed activities it is assumed that an element of this apportionment will cover pension costs. An exact split between appointed and unappointed pension costs cannot be determined as all operating costs in aggregate (including pension costs) are allocated to unappointed activities based on unappointed activity turnover.

3.2.5 We also note that Northgate Information Solutions have been admitted as a participating employer in the Northern Ireland Water Limited Pension Scheme in respect of a number of employees that have transferred to them from the Company in respect of an IT services agreement. No adjustment has been made in the AIR tables or regulatory accounts in respect of these employees.

3.2.6 **Part D Income**

Management have been unable to assess the accuracy of accrued income or show ‘the actual income billed compared to the amount accrued in the previous year’, as the required information is not yet available from the Rapid Xtra billing system to compare year end provisions to actual bills raised post year end.

3.2.7 We note that significant steps have been taken in the current year by management to improve the billing and accounts receivable process however there remain a number of issues in this regard which need to be resolved by management. We note that management are taking active steps to address the remaining issues. These issues include, inter alia, the following:

- Data cleansing in respect of legacy data from the Water Service;
- Recording of income arising from test meters; and
- Timely issue of bills.

3.2.8 We recommend that management take action to resolve the issues identified in 3.2.7 above with particular focus on the cleansing of legacy data from the Water Service. This issue has been raised annually since the inception of NIW as a government owned company and we note that further actions are necessary to resolve this issue.

3.2.9 **Part E Bad Debt**

No exceptions noted.

3.2.10 **Part F Taxation**

[Section 3.2.10 has been redacted].

3.2.11 **Part G Accounting Charges**

During our statutory audit work we identified an issue in respect of the decommissioning of land and buildings. Management had not made any adjustment to account for the impairment/accelerated depreciation in respect of sites that were to be decommissioned in order to ensure that the asset was stated at its recoverable value at the date of decommissioning. As a result a prior year adjustment of £6.3m (historic cost), £7.5m (current cost), was made to both the statutory and regulatory financial statements. We note that the prior year AIR figures included in the comparative information in the current year submission have not been amended to reflect this prior year adjustment, however we note that management have referred to this issue in their commentary.

3.2.12 No exceptions noted but attention is drawn to limitations in estimation of IRC and IRE. See 9.3.1 for further comment.

3.2.13 **Part H Land Sales**

[Section 3.2.13 has been redacted].

3.2.14 **Part I Borrowings**

No exceptions noted.

3.2.15 **Part J General**

[Section 3.2.15 has been redacted].

3.3 **Check that management has included a commentary including an explanation for reporting requirements that do not apply to a particular company.**

3.3.1 For all tables reviewed, management has included a commentary (if applicable) including an explanation for reporting requirements that do not apply to the Company, as outlined in 3.4.1 below.

3.4 **Read NI Water's explanation of reporting requirements that do not apply and check details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

3.4.1 [Section 3.4.1 has been redacted].

3.5 **Check that the figures reported in the Regulatory Accounts tables 6A, 18 to 31, 33, 34, 39, 42 and 43 in the Annual Information Return agree to the underlying accounting records and the final Regulatory Accounts.**

3.5.1 We have reviewed the tables as follows:

NB. references to the 09/10 accounts relate to the audited statutory and regulatory accounts for the year ended 31/03/10.

Table	Description	Comment
Table 6A	Outstanding revenue and breakdown of customer services operating expenditure	Lines 1-28 have no figures as there was no household billing in 09/10. We have agreed lines 29, 31, 33, 43, 45, 47, 57a and 58a (for 08/09) to the Oracle nominal ledger. Lines 29, 31, 33, 43, 45 and 47 have also been agreed to the Aged Debt Listing at 31 March 2010. Household numbers in lines 30, 32 and 34 have been provided by the Rapid Xtra billing System. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 18	Profit and Loss Account (Historical Cost Accounting)	We have agreed lines 1 to 15 (for 09/10) to the 09/10 Regulatory Accounts, to the Oracle nominal ledger and client schedules detailing adjustments made for regulatory purposes. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 18A	[Redacted]	[Redacted]
Table 18B	[Redacted]	[Redacted]
Table 18C	Statement of total recognised gains and losses	We have agreed lines 1 to 4 (for 09/10) to the 09/10 Regulatory Accounts. The actuarial gain reported in line 2 has been agreed to the Statutory Accounts. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return. We note that included in the regulatory accounts statement of total recognised gains and losses is a prior year adjustment in the amount of £6,387k which cannot be agreed to Table 18c as the table format does not support such a disclosure.
Table 18D	Analysis of dividends and interest charges for year	We have agreed lines 1 to 3 to the 09/10 Regulatory Accounts, to the Oracle nominal ledger and client schedules detailing adjustments made for regulatory purposes. Lines 4 to 12 (interest analysis) could not be agreed to the Regulatory Accounts as this disclosure is not required. However the total in line 12 agrees to 'net interest payable' in the Regulatory Accounts. We have agreed lines 4 to 12 to the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. All comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 19	Balance Sheet (Historical Cost Accounting)	We have agreed lines 1 to 33 (for 09/10) to the 09/10 Regulatory Accounts except for lines 13, 18, 19, 21, 22 and 24. This is due to specific disclosure requirements in Table 19 relating to the presentation of deferred income. However the net assets employed total in line 28 agrees to the Regulatory Accounts as it is merely a

Table	Description	Comment
		reclassification within liabilities. We have agreed all lines to the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 19A	Analysis of borrowings due after more than one year (Historical Cost Accounting)	We have agreed the principal sum, nominal interest rate and the carrying value to the 09/10 Statutory Accounts and the carrying value to the Oracle nominal ledger. The principal sum and carrying value has also been agreed to the Regulatory Accounts but the nominal interest rate is not included in the Regulatory Accounts. The years to maturity has been agreed as the number of years from 31 March 2010 to the maturity date of 31 March 2027 per the loan note agreement. As this is a fixed rate instrument, the real coupon rate is agreed as the nominal interest rate adjusted for the RPI assumption.
Table 20	Profit and Loss Account (Current Cost Accounting)	We have agreed lines 1 to 16 (for 09/10) to the 09/10 Regulatory Accounts, to the Oracle nominal ledger and to client supporting schedules detailing adjustment made for regulatory purposes. Comparatives (for 08/09) have been agreed to the 2009 Annual Information Return.
Table 21	Activity Cost Analysis – Water Services	We have agreed lines 1 to 34 (for 09/10) to the 09/10 Regulatory Accounts except for lines 16, 23 and 24 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts. We have agreed the total of line 22 in table 21 and line 21 in table 22 as being the total taken from the Oracle nominal ledger less unappointed costs supported by client schedules. The apportionment of costs to water and sewerage has been agreed to client allocation/apportioning model. The sum of the total of lines 24-26 in table 22 and lines 25, 26 and 27 in table 21 have been agreed to the Oracle nominal ledger and current cost fixed asset register. We have confirmed the arithmetic accuracy of line 16, total business costs which is the sum of lines 13, 14 and 15. Lines 23 and 24 classify certain elements of operating expenditure included in lines 1 to 22 between infrastructure and non-infrastructure reactive and planned maintenance. Lines 23 and 24 are for disclosure purposes only and are not included in total costs. All balances in the NIW Total table have been

Table	Description	Comment
		agreed as being the sum of the NIW only table and the PPP only table.
Table 22	Activity Cost Analysis – Sewerage Services	We have agreed lines 1 to 33 (for 09/10) to the 09/10 Regulatory Accounts except for lines 15, 22 and 23 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts. We have agreed the total of line 22 in table 21 and line 21 in table 22 as being the total taken from the Oracle nominal ledger less unappointed costs. The apportionment of costs to water and sewerage has been agreed to client allocation/apportioning model. The sum of the total of lines 24-26 in table 22 and lines 25, 26 and 27 in table 21 have been agreed to the Oracle nominal ledger and current cost fixed asset register. We have confirmed the arithmetic accuracy of line 15, total business costs which is the sum of lines 12, 13 and 14. Lines 22 and 23 classify certain items of operating expenditure included in lines 1 to 21 between infrastructure and non-infrastructure reactive and planned maintenance. Lines 22 and 23 are for disclosure purposes only and are not included in total costs. All balances in the NIW Total table have been agreed as being the sum of the NIW only table and the PPP only table.
Table 23	Analysis of Turnover and Operating Income	We have agreed lines 1 to 21, with the exception of line 7a (for 09/10) to the 09/10 Regulatory Accounts, the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. Line 7a refers to road drainage revenue which is not separately identified within the regulatory accounts. We have agreed the road drainage revenue in line 7a as being included within other third party services in the regulatory accounts. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return with the exception of a reclassification difference following the inclusion in the current year of an additional line in respect of road drainage revenue. There are two new lines in the current year (22 and 23) relating to movements from the tariff basket – no figures have been included here and managements' commentary highlight that there have been no such events in the current year.
Table 24	Balance Sheet (Current Cost Accounting)	We have agreed lines 1 to 29 (for 09/10) to the 09/10 Regulatory Accounts, the Oracle nominal ledger and client supporting schedules detailing

Table	Description	Comment
		adjustments made for regulatory purposes. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 25	Analysis of Fixed Assets by Asset type	We have agreed lines 1 to 16 (for 09/10) to the 09/10 Regulatory Accounts. Lines 1-16 have also been agreed to the Current Cost Fixed Asset Register plus client schedules of adjustments made for regulatory purposes. Comparatives (for 08/09) have been agreed to the 2009 Annual Information Return after taking into consideration the prior year adjustment impacting upon fixed assets.
Table 26	Working Capital	We have agreed lines 1 to 13 (for 09/10) to the 09/10 Regulatory Accounts and supporting mapping schedules from the Oracle nominal ledger. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 27	Movement on Current Cost Reserve	We have agreed lines 1 to 7 (for 09/10) to the 09/10 Regulatory Accounts except for line 3 which is the sum of £294,257k (Fixed asset RPI adjustment) and £261k (current cost loss on disposal of fixed assets) featured in the Regulatory Accounts. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 28	Cash Flow Statement	We have agreed lines 1 to 23 (for 09/10) to the 09/10 Regulatory Accounts and client workings based on the Statutory Accounts. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 29	Reconciliation of Operating Profit to Net Cash Flow	We have agreed lines 1 to 9 (for 09/10) to the 09/10 Regulatory Accounts and client workings based on the Statutory Accounts. Line 8 – other non-cash profit and loss items is the sum of other non-cash items included, and separately disclosed, in the regulatory accounts. Comparatives (for 08/09 and 07/08) have been agreed to the 2009 Annual Information Return.
Table 30	[Redacted]	[Redacted]
Table 31	[Redacted]	[Redacted]
Table 33	Depreciation charge by asset type	We have agreed lines 3-6 (for 09/10) to the Regulatory Accounts. We are unable to agree lines 1 and 2 to the Regulatory Accounts as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts. We have agreed lines 1-2 to client supporting schedules, 3 and 6 to the Oracle nominal ledger adjusted for regulatory purposes, 5 to the Oracle

Table	Description	Comment
		nominal ledger and 4 to the CIDA system. Comparatives (for 08/09) have been agreed to the 2009 Annual Information Return.
Table 34	Analysis of non-infrastructure fixed asset additions by life categories	We have agreed lines 1-7 and 9-13 to the CIDA summary model. Per review of the current cost FAR lines 15-19 appear reasonable. We have reconciled lines 8 and 14 to the Regulatory Accounts and table 32.
Table 39	[Redacted]	[Redacted]
Table 42	[Redacted]	[Redacted]
Table 43	[Redacted]	[Redacted]

3.6 **Where there are subsequent changes to the Regulatory Accounts, compared to the submitted Regulatory Tables, NI Water should write to NIAUR setting out any differences between the submitted Regulatory Tables and the finalised Regulatory Accounts and the reasons for the changes. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

3.6.1 Regulatory Accounts were signed on 29 June 2010, pre-submission of the Annual Information Return – there were no adjustments made between the signed Regulatory Accounts and the Annual Information Return in respect of the 2010 figures. We do note however that the prior year adjustment in respect of site decommissioning that has restated the 2009 comparative figures in the regulatory accounts has not been reflected in the 2009 comparative figures in the current 2010 AIR submission.

3.7 **Read NI Water's response to the Regulator's queries and check that NI Water's commentary is consistent with the Regulatory Accounts and the underlying accounting records.**

3.7.1 We have reviewed NIW's log of queries received from NIAUR in respect of AIR 09 and the responses provided by NIW in respect of financial tables only. All issues raised have been addressed in full and where applicable further clarification has been provided in AIR 10 commentaries.

3.8 **The full wording of the opinion NIAUR require for the Regulatory Accounts for 2009/10 is set out in Annex A. Where NI Water submits a set of Regulatory Accounts that does not contain this wording, NIAUR will not consider it to be compliant with licence condition F. The wording of the opinion NIAUR require for the Annual Information Return is set out in Annex B.**

3.8.1 The wording of the opinion on the Regulatory Accounts is consistent with that set out in Annex A of the Auditors' Guidance. The wording of the opinion on the regulatory tables as presented on page 2 and 3 differs from that in the auditor's guidance but is consistent with that agreed between NIAUR, NIWL and KPMG in the engagement letter. The report differs due to the fact that as the Regulatory Accounts are submitted to NIAUR prior to submission of the Annual Information Return, we have removed the reference in the opinion paragraph to any expected differences between the Regulatory Accounts and the Annual Information Return, and state that these are consistent.

3.9 **NIAUR expect, given the timescales of submission for the Annual Information Return 2010, that information in the Annual Information Return submission and the Regulatory Accounts will be consistent and that auditors will be able to agree the Annual Information Return figures to the Regulatory Accounts. Where this is the case, we would expect auditors to issue an opinion confirming consistency of the information in the Annual Information Return and the Regulatory Accounts as set out in Annex B.**

If there are any material differences between the Annual Information Return submission and the Regulatory Accounts, these should be detailed and explained in a covering letter by the auditors.

3.9.1 There are no material differences between the AIR and the Regulatory Accounts.

4 Part B – Activity Cost Analysis (Tables 21 & 22)

In line with the NIAUR guidance the following materiality has been used for Part B:

- All items excluding bad debt charge & atypicals (1% of OPEX) - £3.1m
- Bad debt charge (10% of £1.1m) - £110k
- Atypicals – all items reviewed

4.1 Read NI Water's explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that this explanation is consistent with the preparation basis of the Regulatory Table and the underlying accounting records.

4.1.1 The Company's explanation of the procedures used to allocate costs is consistent with our understanding and our review and walkthrough of the allocation and apportionment model designed and implemented by the company.

4.1.2 NIW have restated a number of balances that were originally submitted as part of AIR 2009 following discussions with the Water Reporter and NIAUR in respect of cost allocation. Managements' commentary in respect of significant movements refers to these restated balances. We have considered management's commentary in this regard but have not carried out any work on the restated 2009 AIR figures.

4.1.3 We selected five expenses from Table 21 and five expenses from Table 22, obtained a breakdown by service activity for each expense selected and traced the balance back to the statutory nominal ledger to ensure that the balance was (i) complete, and (ii) accurately allocated in accordance with the company methodology as detailed in the management commentary.

4.1.4 Each balance could be traced from the Oracle nominal ledger through to the Regulatory Accounts and relevant tables from the Annual Information Return, and had been allocated correctly as detailed in the management commentary.

4.1.5 Furthermore, a reconciliation was carried out on the Oracle nominal ledger in order to ensure that all statutory operating costs less any un-appointed costs were accounted for correctly within tables 21 and 22. This reconciled and all relevant costs had been included.

4.2 For any judgements, apportionments or adjustments identified by management in (4.1), agree that these are consistent with the basis of preparation of the Regulatory Table and, where relevant, the underlying accounting records.

4.2.1 Operating costs are downloaded from Oracle by nominal ledger code into an excel spreadsheet where they are allocated to services (i.e. Water or Sewerage) and then service areas (i.e. Resources and Treatment, Distribution). As general and support expenditure cannot be directly mapped to service areas, a basis of apportionment is applied. The cost apportionment methodology is based on the total direct costs incurred in each service area. The costs to be included within general and support have been agreed with the NIAUR in the current year.

4.3 **Obtain management's commentary for changes in judgements, apportionments or adjustments when compared with the prior year. Read NI Water's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

4.3.1 There has been a change in the methodology with respect to the calculation of direct costs and general and support costs. In AIR09 after all direct costs were mapped to the direct cost line, business partners would then review 'indirect' general costs and allocate the spend on an appropriate basis to direct costs. All remaining unallocated costs were then included as General and Support Expenditure and apportioned to each service area based on a percentage of the total direct spend. In AIR 09 total direct costs totalled £145.42m and General and Support Expenditure totaled £13.65m.

4.3.2 The above methodology was disapplied following consultation with the NIAUR in 2009/2010. Direct costs no longer include an element that is allocated by business partners based on their judgement. All 'indirect costs' are now included as general and support expenditure in the first instance and, as detailed in managements' commentary for tables 21 and 22, are apportioned either on the basis of spend that is directly coded to a service area or on the basis of total direct costs incurred by the respective service area. As a result in AIR 2010 the amount of general and support expenditure has increased to £46.6m (AIR 2009: £13.65m) and direct costs have decreased to £95.14m (AIR 2009: £143.4m)

4.3.3 Management has prepared restated AIR 09 tables 21 and 22 applying the AIR 2010 methodology. In the restated AIR 09 tables general and support expenditure totals £64.4m. Management's commentary to tables 21 and 22 explain the reduction in general and support expenditure based on the restated AIR 09 tables. We have not carried out any work in respect of the restatement of the AIR 09 tables.

4.3.4 Given the increased level of general and support expenditure under the new methodology the apportionment of these costs between the service areas on the basis of direct costs may not result in an accurate reflection of the costs attributable to these service areas. We recommend that management carry out a detailed analysis to evidence that this new methodology provides a more accurate basis for allocation and apportionment. We recommend that further granularity is obtained in respect of the costs incurred.

4.4 **Obtain management's commentary on all items noted as being 'exceptional' or 'atypical'. Read NI Water's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. For atypical item, compare costs in the report year with historic actual costs for that item. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

4.4.1 Management has identified three items (£0.5m of costs as a result of the very cold weather in January 2010, £6.4m of costs incurred under the Business Improvement Programme and £5.1m of costs in respect of voluntary early retirements) in the year that they consider atypical and reorganizational operating expenditure items for AIR reporting purposes. No exceptional items have been identified. We note that management have not made specific reference to atypical costs incurred in respect of contractual claims due to the commercial sensitivity of the dispute. We do note, however that management have included a generic commentary in respect of contractual claims. With the exception of this lack of specific disclosure we consider the commentary to be consistent with our understanding of the basis of the additional costs. The increase in costs has been supported by management assessment and agreed to underlying accounting records.

4.5 **Obtain management's capitalisation policy which should also highlight any changes from the prior year. Read NI Water's commentary and check that it is consistent with the policies applied in the Regulatory Accounts and the underlying accounting records.**

4.5.1 There has been no change in management's capitalisation policy which is detailed in the commentary to tables 21 and 22. The commentary is consistent with the policies applied in the Regulatory Accounts and the underlying accounting records and agrees to the capitalisation guidance published by NIWL. However from discussions with management it has been noted that the current criteria that all capital spend must exceed £3,000 will be reduced to £1,000 from April 2010. Sampling of expenditure on capital projects performed during the statutory audit fieldwork confirmed that the policy in place during the 2009/2010 financial year was applied. Additionally audit testing performed during the statutory audit fieldwork identified several internal control weaknesses with regard to fixed assets that have been communicated to management in the 2010 board report. These issues include:

- Overstatement of adopted assets due to breakdown in internal communication;
- Inaccuracies in transferring items from assets in the course of construction to the relevant fixed asset category;
- Failure to update fixed asset register to reflect changes made to Captrax emanating from reclassification of meters within zonal projects; and
- Failure to account for accelerated depreciation on land buildings where a decision had been taken in prior years to decommission the site.

4.5.2 We have made a number of detailed recommendations to management in respect of the issues outlined above and also recommend that management consider any potential impact of the new threshold on the Infrastructure Renewals Charge.

4.6 **Trace the costs relating to 'movements in provisions' (including legal provisions) to the Regulatory Accounts and the underlying accounting records.**

4.6.1 All material movements in provisions have been agreed to the Regulatory Accounts, statutory nominal ledger and client schedules based on legal advice and management assessment.

4.7 **Obtain management's commentary in relation to reorganisation costs which should include a brief description of what costs have been included (split between redundancy costs and pension strain etc.) along with details of when the expenditure is expected to be incurred. Read NI Water's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

4.7.1 The Company have noted three reorganisation costs in their commentary. The Business Improvement Programme ('BIP') consists of a series of major projects set up with an aim to meet or exceed performance levels of similar English and Welsh water companies. These costs have no redundancy or pension element.

4.7.2 Costs in respect of the Voluntary Early Retirement (VER) programme have been split into pension and non-pension elements and the Company have noted how much has been paid and accrued at the year end.

4.7.3 The provision for contract termination costs (included within the AIR 2010 tables but not specifically commented on due to their commercial sensitivity) represents management's best estimate of costs to be incurred in respect of the early termination of a supplier contract.

4.7.4 All three costs have been agreed as included in operating expenditure in the Regulatory Accounts and reconciled to the Oracle nominal ledger. The expected timing of expenditure has been disclosed in the commentary to tables 21 and 22, if known.

4.8 To the extent not covered by Ofwat's RAG 5.04 work on transfer pricing, check if any adjustment has been made to exclude non-appointed business costs from the Regulatory Accounts Table. Agree the adjustment to the underlying accounting records and/or the Regulatory Accounts.

4.8.1 The Company excludes non-appointed operating costs (£3,016k) from the activity cost tables in the Regulatory Accounts. The activity costs reported in the AIR have been reconciled and agreed to both Statutory and Regulatory Accounts. The amount deemed non-appointed has been agreed to client apportioning schedules.

5 Part C – Pensions (Tables 18, 18a, 18c, 18d, 19, 20, 21, 22 & 24)

In line with the NIAUR guidance, 5% of the FRS17 operating profit charge (5% of £22,963k = £1,148k) has been used as materiality for Part C.

5.1 **Obtain an explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that NI Water's explanations and, in particular the apportionments of the FRS17 charge across several lines in tables 21 and 22, is consistent with the Regulatory Accounts and the underlying accounting records.**

5.1.1 An explanation of the procedures used to allocate costs including pension costs, is included in the commentary for tables 21 and 22. Tables 21 and 22 have been agreed to the Regulatory Accounts as detailed in section 3.5.1 and reconciled to NIWL's Oracle nominal ledger. Pension costs for those employees who can be directly attributed to service or business activities are directly mapped to these areas via the wages and salaries codes. However pension costs that relate to either employees not engaged directly on service/business activities or that relate to past service costs have been apportioned to activities in line with the treatment of general and support expenditure (see 4.3.1). We have not identified any inconsistencies between the Company's explanations, the Regulatory Accounts and underlying information.

5.2 **Check that an adjustment has been made for employees who are outside of the appointed business.**

5.2.1 Management have been unable to separate out the FRS17 charge or the pension asset relating to those employees in the non-appointed business. However, these employees represent a small minority of the total number in the scheme and any allocation is not expected to be material. The commentary to tables 21 and 22 notes this departure from reporting requirements.

5.2.2 We note that Northgate Information Solutions have been admitted as a participating employer in the Northern Ireland Water Limited Pension Scheme in respect of a number of employees that have transferred to them from the Company in respect of an IT services agreement. No adjustment has been made in the AIR tables or regulatory accounts in respect of these employees.

5.3 **Check that the amounts included for the interest cost in table 18d and the balance sheet position in tables 19 and 24 can be agreed to the Regulatory Accounts, and where relevant the pension disclosure notes provided by NI Water's actuary.**

5.3.1 Tables 18d, 19 and 24 have been agreed to the Regulatory Accounts and pension disclosure notes provided by the Company's actuary where applicable.

5.4 **Where any apportionments are identified in 5.1 and 5.3, obtain from management a commentary identifying any changes in apportionment policy from the prior year. Agree the new basis to the basis of preparation of the Regulatory Accounts.**

5.4.1 Pension costs have not been split between Appointed and Non-Appointed business, as set out in 5.1.1 above – therefore no apportionments have been made in relation to pension costs.

5.5 **Obtain NI Water's commentary on the comparison of actual contributions to those set out in the final determination. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other**

supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.

5.5.1 The Company's commentary to tables 21 and 22 states an employer's contribution rate of 29.3% from April to October 2009 and 26.9% from October 2009 to the year end (2009: 29.3%). We have tested and confirm that these are the rates at which contributions have been paid during the year. 26.9% is the contribution rate specified in the Schedule of Contributions as agreed by the company, scheme trustees and actuary.

5.6 **Through discussions with management, comment on any changes to future contribution levels that have been agreed with the pension scheme trustees which will commence after the year-end. If changes are noted, provide details and the details of supporting documentation that was made available.**

5.6.1 Future levels of contributions have been agreed between the company the trustees of the pension scheme and have been formally set out in a schedule of contributions. Note 25 of the statutory accounts indicates that management anticipate contributions of approximately £10.4m in 2010/2011 based on the Schedule of Contributions agreed by the actuary.

5.7 **For defined benefit schemes, trace the level of cash contributions stated by NI Water to the underlying accounting records.**

5.7.1 Cash contributions for the defined benefit scheme have been agreed to bank statements, as having been paid.

5.8 **Where NI Water contributes to both a defined benefit and a defined contribution scheme, check the split to the underlying accounting records.**

5.8.1 The Company does not have a defined contribution scheme.

5.9 **Trace any lump sum contribution to the underlying accounting records and NI Water's commentary.**

5.9.1 Additional lump sum contributions totalling £7.5m were paid into the Company Pension Scheme during the year. These contributions covered the costs of augmenting pensions in line with the Voluntary Early Retirement (VER) Scheme, as calculated by the scheme actuary. Such contributions have been agreed to bank statements as paid in the year and reconciled to the Oracle nominal ledger.

5.10 **Obtain from NI Water, detail of changes in actuarial assumptions underpinning the FRS17 valuation that have occurred since the previous year-end. Agree these assumptions to the FRS17 report provided by NI Water's actuary.**

5.10.1 We note that, as disclosed in Note 25 to the statutory accounts, prior to February 2009 members had the option of transferring their past service benefits from the Principal Civil Service Pension Scheme (NI) to the new NIWL pension scheme. The company had assumed in 07/08 that 50% of employees would transfer past service benefits and the actuary had therefore presented the sensitivities of the pension liability to a variation in the assumed level of transfer. However, the actual take up rate was significantly lower (approximately 20%). The 09/10 disclosures have reflected this outcome by recognising the obligation to take on members' PCSPS (NI) accrued rights and making provision for the expected amount of bulk transfer payments in assets. All other changes in actuarial assumptions have been agreed to the FRS 17 report provided by NIW's actuary.

5.10.2 The key assumptions in 2010 and 2009 are set out below:

Assumption	2010	2009
Discount rate	5.75%	6.75%
Inflation	3.75%	3.5%
Rate of increase in salaries	4.75%	45.%
Rate of increase in pensions in payment and deferred pensions	3.75%	3.5%

Changes in mortality assumptions have led to a relatively small increase in expected longevity of members and thereby an increase in the pension liabilities.

5.11 **Where there has been a change in the level of contributions within the year, check that management has included a commentary on the difference in the relative amount of contributions being used to fund any deficit. If changes are noted, provide details and the details of supporting documentation that was made available.**

5.11.1 A new schedule of contributions, certified by the Scheme Actuary during the year, became effective from 1 October 2009. Consequently, employer contribution rate decreased from 29.3% to 26.9%. As there is currently a pension asset (surplus) of £2.26m, contributions have not been used to fund any deficit, and there has been no commentary included to this effect. We agreed new rate of contributions to the revised schedule of contributions.

6 Part D – Income (Tables 23 and 26)

In line with the NIAUR guidance 0.1% of turnover (i.e. £347k) has been used as materiality for Part D.

6.1 **Read management's reconciliation and commentary of the amounts billed to the reported turnover. Where there are adjustments, (other than for the measured income accrual) management's commentary should set out whether these are one-offs for the current year or repeated. Where the adjustments occur annually, management should comment on the size of the adjustment compared to the previous year. Read NI Water's commentary and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

6.1.1 Management have reconciled the billed income figure reported in Table 23 to Echo reports for the year, after making manual adjustments for movements in accrued and referred income, movements in test meter billing, adjustments in respect of incorrect bills raised in prior years relating to pipe sizes and other miscellaneous adjustments. Referred income relates to bills raised and included in Rapid Xtra billing reports, but not accounted for by NIW as they are currently under investigation. Total turnover, opening and closing accrued/referred income and manual adjustments have all been agreed to the Oracle nominal ledger, the remaining billed income figure to Echo reports. We have also verified the arithmetical accuracy of the reconciliation.

6.1.2 Management have made specific reference to three balances within their commentary to Table 23, which required further explanation to the user. Firstly, £240,354k is included as 'unmeasured household income' – this relates entirely to subsidy income from DRD provided in lieu of domestic charging in 2009/10. Secondly, the £73,542k included as 'measured non-household income' comprises £58,258k non-domestic billed income and a further £15,284k of subsidy income received from DRD in lieu of phased charges. Finally, £19,670k income from DRD in respect of road drainage is separately identified within the table (classified in other sources in prior year).

6.2 **Based on discussion with management and sight of underlying documentation, describe NI Water's procedures for monitoring revenue, including who reviews the revenues against the SBP and forecasts, the process for identification of variances and whether any sensitivity analysis takes place. Describe the nature of the underlying documentation observed.**

6.2.1 Measured and unmeasured water and sewerage revenue are monitored against the budgetary position on a monthly basis and variances investigated. This process is undertaken by representatives from Financial Accounts, Management Accounts and Customer Services. Monthly variances are also reviewed by the Finance Director and Customer Services Director, who subsequently prepare a report for submission to the Board. The annual budget is based on the SBP, after adjusting for a change in revenue mix given the deferral of domestic charges and phasing of subsidy income, not anticipated when the original plan was set in 2007. No formal sensitivity analysis is performed. We recommend that a formal sensitivity analysis is carried out.

6.2.2 The monitoring process introduced in the prior year has been further refined in the current year whereby the use of the Dynamic Consumption Report ("DCR") and quarterly re-forecasting has been further developed. The Finance and Customer Services teams meet on a monthly basis to discuss emerging variances with the DCR allowing underlying trends in consumption to be compared to the volumetrics underpinning the forecasted information and can provide logical explanations for under/over achievement in revenue targets.

6.2.3 We recommend that given the current economic environment and the fluctuations in consumption management should increase the frequency of their re-forecasting to a monthly basis. The maximisation of the forecasting potential of the DCR will enable the company to make more informed strategic decisions and will also ensure that the budgeting position is as accurate as possible.

6.3 **Obtain the commentary given by NI Water on both revenue reported and to explain variances between the actual and forecasted revenue in the SBP. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

6.3.1 The Company have noted in their commentary that total revenue for 2009/10 was £12.0m (3.3%) below budget. The majority of this movement may be attributed to the measured water and sewerage (excluding subsidy income) category where customer numbers and average consumption have both fallen against budget, primarily as a result of inaccuracies in the preparation of the 2009/10 budget. Furthermore, customers in general have reduced their usage, while certain businesses have also ceased trading. Actual revenue figures have been agreed to the Oracle nominal ledger. Budget figures are those set by the tariff group and explanations in respect of turnover variances are those provided by the Customer Service Team.

6.4 **Obtain management's commentary on the basis of the measured income accrual. Read NI Water's commentary and agree the accrual and supporting details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

6.4.1 The commentary on the basis of the measured income accrual was reviewed and is consistent with our understanding established during the statutory audit. The level of measured income accrual noted for 09/10 has been agreed to the Oracle nominal ledger and underlying customer billing reports. We have also reviewed the provisioning levels against accrued income and note that the policy is consistent with that used in the prior year with the exception of accrued income that is between 211 and 365 days old which is now fully provided against (2008/09 – 90%).

6.5 **Where management has calculated a retrospective review of the previous year's accrual compared to the amounts actually billed, agree the amounts reported to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation. Where management are not able to complete a retrospective review of the previous year's accrual, ensure that NI Water has included an explanation of the reasons for this in their commentary.**

6.5.1 Management are currently unable to compare amounts billed to those previously accrued, as Echo have, to date, been unable to provide this information. Management have referred to this in their commentary to Table 23 where they note that they are currently working with Echo to incorporate this as part of the monthly analysis to ensure that variance between the accrual calculation and subsequent billing are fully understood.

6.5.2 We recommend that management carry out an exercise to ensure that the amounts billed can be reconciled to the amounts accrued on a monthly basis.

6.6 **Check the amounts reported in net revenue movement out of the tariff basket (water and sewage service) agree to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

6.6.1 There has been no net revenue movement out of the tariff basket, as stated in the commentary.

7 Part E – Bad Debt (Tables 6a, 21 and 22)

In line with the NIAUR guidance the following materiality levels have been used for part E:

- Bad debt charge – movements of +/- 10% of bad debt charge i.e. +/- £83k
- Write offs – movement of +/- 0.1% of turnover i.e. +/- £347k
- Revenue outstanding – movement of +/- 1% of turnover i.e. +/- £3.47m
- We have assumed a materiality threshold of 0.1% of turnover for customer services operating expenditure i.e. £347k

General Procedures

7.1 **Obtain NI Water's commentary on whether the data has been extracted directly from their billing systems or whether numbers have been manually calculated or adjusted in some way, for example to allocate data between households and non-households. Read NI Water's explanation and agree details of any assumptions or apportionment stated in the basis of preparation to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

7.1.1 The data illustrated on lines 29 and 43 of Table 6a summarise revenue outstanding from non-households only. Household billing had not commenced in 09/10 therefore no such income has been recognised and as such there is no outstanding revenue at the year end.

7.1.2 As noted earlier, NIWL have outsourced billing and debt collection to Echo.

7.1.3 The balances on line 29 and line 43 have been extracted directly from the aged debt listing created using information from the Rapid Xtra Billing System provided by Echo on a monthly basis and manually reconciled to the Oracle nominal ledger. The reconciliation is consistent with the reconciliation audited as part of our statutory audit work. Reconciling items have been agreed to supporting documentation, and balances agreed to Oracle nominal ledger.

7.1.4 The nominal ledger figure is £1,377k greater than the Rapid Xtra Debtors Ledger figure due to reclassification of credit balances (£2,237k) and an adjustment in respect of potentially irrecoverable debt (£85k), offset by test meters which have been recognised in the Oracle nominal ledger but are not yet billed (£747k) on Rapid Xtra, plus additional revenue which have been recognised in the Oracle nominal ledger but not yet billed (£198k) on Rapid Xtra. The test meter adjustment of £747k is stated after a provision of £750k (2008/09: £1.2m).

7.1.5 We have recommended to management, as part of our statutory audit work, that management should take all necessary steps to ensure that credit balances on the debtors ledger are minimised and where possible that these monies are returned to customers. We note that a number of these credit balances relate to legacy issues referred to in 3.2.7.

7.1.6 The information for revenue written off of £353k populated in lines 57a and 58a has been reconciled to the Oracle nominal ledger.

7.1.7 The customer services operating expenditure of £18,558k in line 59 has been agreed as the total of line 13 in Table 21 and line 12 in Table 22. This total has been agreed to the Regulatory Accounts.

7.2 **Trace the data to NI Water's accounting records/billing systems. Describe the source of the underlying accounting records or billing systems that data has been agreed to.**

7.2.1 The total revenue outstanding detailed in lines 29 and 43 has been reconciled to the Oracle nominal ledger which agrees to the Regulatory Accounts. We have reviewed the reconciliation between the Oracle nominal ledger and the Rapid Xtra billing system as described in 7.1.4 above.

7.3 **Obtain NI Water's commentary on any changes in reporting methodologies (for example, apportionments used in calculating outstanding revenue collection operating expenditure) from year to year and the effect this will have on the data reported in the current, past and/or future years. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.3.1 There have been no changes in reporting methodologies since the prior year. The income split by category has been reconciled to the Oracle nominal ledger. Explanations for variances provided by management supports our understanding of the debtors/income process established during the statutory fieldwork.

7.4 **For any changes in methodology check that the previous years' data has been adjusted. If previous years' data has not been adjusted, discuss with management and state NI Water's reasons for this.**

7.4.1 There have been no changes in methodology that require an adjustment to prior year figures, however we have noted a change in the method of calculating the number of non households with revenue outstanding. In the prior year, where a property had revenue outstanding across more than one age band, this was reported as 2 properties with revenue outstanding. In the current year, where a property has revenue outstanding across more than one band, it has been reported against the oldest age band only.

Specific procedures – revenue outstanding

7.5 **Describe the nature of the revenue outstanding reported in lines 1 to 56 (i.e. confirm that the definition of 'revenue outstanding' as set out in NI Water reporting requirements had been adhered to) of the Regulatory Table 6a and state where this information has been extracted from.**

7.5.1 Domestic billing has been postponed until 10/11; hence lines 1-28 remain blank. The revenue outstanding reported in line 29 is that of non-domestic measured water, measured sewerage and trade effluent billing. This is further broken down in lines 31 and 33. The revenue outstanding per line 43 is that of non-domestic unmeasured water and sewerage. This information has been reconciled to the statutory accounts nominal ledger. Information is posted into the nominal ledger on a monthly basis from the information pack derived from the Rapid Xtra billing system.

7.6 **Check that the revenue outstanding shown in these lines has been aged into the relevant time bands correctly, through agreement to underlying accounting records. Specify the details of the underlying aged debt report or other accounting records that the revenue outstanding has been agreed to and details of sample tested.**

7.6.1 The ageing of outstanding debt has been agreed to underlying accounting records and agrees with work performed during the statutory fieldwork. The aged debt report provides totals for measured, unmeasured and trade effluent debtor categories aged from 0-30, 30-60 up to 365 days, after which it continues 1-2 years up to 4+ years. We tested a sample of invoices to ensure they had been aged correctly and reviewed movements with the prior year.

7.7 **Check that NI Water has provided explanations for any material changes (+/- 20% between the report year and the previous year) in the "revenue outstanding" lines. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.7.1 Revenue outstanding has increased by £4.5m (54%) on prior year due to the full phasing in of additional three income streams – measured sewerage, unmeasured water and unmeasured sewerage, introduced in the prior year. This explanation is included in the commentary and is consistent with our understanding of debt collection and movements observed during statutory fieldwork. The opening and closing revenue outstanding balances for the year have been agreed to reports generated by the Rapid Xtra Billing system.

7.8 **Check that the sum of the total revenue outstanding lines (lines 1, 13, 15, 27, 29, 41, 43 and 55) reconciles to the debt reported on NI Water's General Ledger. If numbers do not reconcile, test the reason for the difference in management's commentary can be agreed to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.8.1 The total revenue outstanding per line 29 and line 43 was reconciled to the Company's nominal ledger.

7.9 **Check that the reasons for any adjustments made to revenue outstanding between data extracted from billing or accounting systems and that reported in the Regulatory Table can be supported by the underlying records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.9.1 Total revenue outstanding for non households differs by £1,377k from the statutory financial statements due to (i) reclassification of credit balances of £2,237k; (ii) adjustment of irrecoverable debt of £85k; offset by (iii) test meters which have been recognised in the Oracle nominal ledger but are not yet billed of £747k on Rapid Xtra, plus additional revenue which have been recognised in the Oracle nominal ledger but not yet billed (£198k) on Rapid Xtra.

7.10 **Check that 'non-household revenue outstanding' has been correctly extracted from NI Water's underlying accounting records or other supporting documentation. Describe the nature of costs that have been reported.**

7.10.1 Line 29 - the total of non-household revenue outstanding has been reconciled to the Company's nominal ledger.

Specific procedures – Customer Service Operating Expenditure

7.11 **Obtain NI Water's commentary on the basis of allocating customer services operating expenditure (between lines 59 to 63). Check that this is consistent with the underlying accounting records and other supporting documentation.**

7.11.1 Customer services operating expenditure has been allocated to line 59 only due to there being no household billing in 09/10 and hence there are no associated costs in respect of the collection of household debt. Similarly there have been no donations to charitable trusts assisting customers in debt nor any operating expenditure incurred due to vulnerable household customers. The allocation of this customer services operating expenditure follows the same methodology as detailed in the commentary to Tables 21 and 22. Further work has been performed on the allocation methodology in section B – Activity Costing Analysis including walkthroughs of a sample of expense items to confirm that the allocation is being carried out as described in the methodology included in the commentary to Tables 21 and 22 – no issues were noted.

7.12 **Check that NI Water has provided an explanation for any material changes (+/-30% between report year and previous year) in data reported in the 'customer service operating expenditure' lines. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.12.1 Customer services operating expenditure has increased by 10% on prior year, hence no explanation for marginal variance required.

7.13 **Describe the basis of allocating outstanding revenue collection operating expenditure in line 60 and 60a.**

7.13.1 As domestic billing has been postponed, there is no operating expenditure incurred in relation to households. No balance has been reported in this line.

7.14 **Check that reported numbers for household costs for outstanding revenue collection operating expenditure in line 60 can be agreed to the underlying accounting records or other supporting documentation. Obtain NI Water's commentary and check that NI Water has provided reasons for any material differences (+/-30% between the report year and the previous year) in each element. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.14.1 Not applicable as there was no domestic billing in 09/10 therefore no outstanding domestic revenue at the year end and no balance reported in line 60.

7.15 **Where a company has commented on a change to the methodology used to compile line 60 auditors should agree this to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.15.1 Not applicable as there was no domestic billing in 09/10 therefore no outstanding domestic revenue at the year end and no balance reported in line 60.

7.16 **Trace any amount reported in line 61 (Donations to charitable trusts assisting customers in debt) to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.16.1 The Company made no donations to charitable trusts assisting customers in debt as noted in the commentary to this table and no balance reported in line 61.

7.17 **Trace line 63 to the sum of table 21 line 13 and table 22 line 12. If they are not in accordance, check that reasons for any difference can be agreed to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.17.1 The total figure in line 63 has been agreed to the total of line 13 in table 21 plus the total of line 12 in table 22.

7.18 **Where NI Water has included an explanation of any significant exceptional capital costs associated directly with outstanding revenue collection or provision for vulnerable customers, agree these to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.18.1 No significant exceptional capital costs have been described in the Company's commentary.

Specific procedures – interaction between charge, provision and outstanding revenue

7.19 **Obtain a commentary from management on the bad debt provisioning policy, particularly where this has changed from the prior year. Where a change has been reported to have taken place, check that this is consistent with the Regulatory Accounts and the underlying accounting records.**

7.19.1 The bad debt provisioning policy has been included in the commentary to Table 6a. This is consistent with the prior year policy. The bad debt policy included is consistent with the policy that has been applied in deriving the bad debt provision in the statutory accounts and regulatory accounts.

7.20 **Provide in a table the level of consistency over time between the bad debt charge (from Tables 21 and 22), and revenue outstanding (Lines, 1, 13, 15, 27, 29, 41, 43 and 55 of table 6a). Through discussions with management, explain any large movements.**

7.20.1 The level of revenue outstanding has increased in the year due to the influences outlined in 7.7.1 above.

Table	**Line**		**AIR 2010 £m**	**AIR 2009 £m**	**AIR 2008 £m**	**Variance from 2009 AIR to 2010 AIR £m**
21	18	Doubtful debts	0.648	2.131*	(0.544)	(1.483)
22	17	Doubtful debts	0.463	1.094*	-	(0.631)
6a	1	Total revenue outstanding < 48 months (measured households)	-	-	-	-
6a	13	Revenue outstanding > 48 months (measured households)	-	-	-	-
6a	15	Total revenue outstanding < 48 months (unmeasured households)	-	-	-	-
6a	27	Revenue outstanding > 48 months (unmeasured households)	-	-	-	-
6a	29	Total revenue outstanding < 48 months (measured non-households)	12.721	7.875	7.029	4.846
6a	41	Total revenue outstanding > 48 months (measured non-households)	-	-	-	-
6a	43	Total revenue outstanding < 48 months (unmeasured non-households)	0.302	0.584	-	(0.282)
6a	55	Total revenue outstanding > 48 months (unmeasured non-households)	-	-	-	-

* From restated 2009 AIR tables, unaudited balances. The change from the submitted prior year AIR tables relates to a reclassification of doubtful debts between water and sewerage.

7.20.2 The prior year bad debt charge (£3.225m) is the result of £278k bad debts written off and a £2,947k increase in bad debt provision. The total bad debt charge in the current year of £1,111k has been apportioned to tables 21 and 22 on the basis of proportion of income received, i.e. 58.4% allocated to table 21 (Water) and 41.6% to table 22 (Sewerage). The current year bad debt charge relates to £353k bad debts written off and a £758k increase in provision. The reduction on prior year expense is a result of increased efforts made during the year to recover debts and a reduction in respect of provisions made against test meter income.

7.20.3 We note that there are limitations when reviewing the consistency over time of between the bad debt charge and revenue outstanding in a start up situation due to the following factors:

- Phasing in of charges
- Billing of test meter income and associated provisioning
- Revisions to bad debt provisioning policies in light of experience

7.20.4 Line 29 of table 6a representing measured non household debt has increased by £4.846m from the prior year due to the complete phasing in of the three new income streams (50% phased in 2009) and increased tariffs.

7.20.5 Line 43 of table 6a representing unmeasured non household debt less than 48 months old has decreased by £0.282m from the prior year as a result of ongoing attempts to improve cash collection during the year.

7.20.6 Lines 1, 13, 15 and 27 above relate to domestic debt and as such are not applicable for the company.

7.20.7 Lines 41 and 55 above relate to non-domestic debt greater than 48 months old. These debts are fully provided for and as such are included at nil value.

7.21 **For the effect of changes in the provisioning policy (set out in management's commentary), obtain an assessment of the impact of the change and agree to supporting documentation. Describe the nature of the supporting documentation.**

7.21.1 The Company's provisioning policy has not changed from prior year.

8 Part F – Taxation (Tables 18a and 18b)

[Part F – Taxation (Tables 18a and 18b) has been redacted].

9 Part G – Accounting Charges (Table 33 & 34)

Current Cost Depreciation (CCD) - Table 34

9.1 **Check that any amounts reported by NI Water for assets fully depreciated still in use and assets written off or replaced in the year which were not fully depreciated can be agreed to the underlying accounting records.**

9.1.1 During our statutory audit work we identified an issue in respect of the decommissioning of land and buildings. Management had not made any adjustment to account for the impairment/accelerated depreciation in respect of sites that were to be decommissioned in order to ensure that the asset was stated at its recoverable value at the date of decommissioning. As a result a prior year adjustment of £6.3m (historic cost), £7.5m (current cost), was made to both the statutory and regulatory financial statements. We note that the prior year AIR figures included in the comparative information in the current year submission have not been amended to reflect this prior year adjustment, however we note that management have referred to this issue in their commentary.

9.1.2 The current cost net value of assets fully depreciated but still in use, has been agreed to the fixed asset register. At 31 March 2010, there are fixed assets with total gross current cost of £6,931k (2009: £2,967) with a Net Current Replacement Cost (NCRC) of zero still in use. These have been agreed to the fixed asset register at the year end. A significant number of assets were decommissioned in 2009/2010 following an extensive management review. Assets written off in the year but not fully depreciated with a Gross Current Replacement Cost (GCRC) of £21,525k and accumulated depreciation of £3,216k have been agreed to the current cost fixed asset register and regulatory accounts.

9.1.3 We noted during our audit work that the current cost valuation of fixed assets was not based on a Modern Equivalent Asset Value (“MEAV”) basis as is required in regulatory accounting guidelines. This fact was disclosed by management in the regulatory accounts and we have drawn this to the attention of the reader of the accounts in our audit opinion. We have also raised a management letter point in this regard.

9.2 **NB. Include any specific procedures required by the Reporter in addition to 9.1 above.**

9.2.1 No specific procedures were requested by the reporter to be completed by KPMG.

Infrastructure Renewals Charge (IRC) - Table 33

9.3 **Check that the Infrastructure Renewals Charge is based on an operational assessment of activity needed to maintain the serviceability of the underground infrastructure over a reasonably long period using the definitions within RAG 1.04.**

9.3.1 The calculation of the infrastructure renewals charge has been reviewed. It is based on a limited operational assessment of activity needed to maintain the serviceability of the underground infrastructure using the definitions within RAG 1.04. This operational assessment is based on an average of the previous five years Infrastructure Renewals Expenditure ('IRE') and the projected five year IRE for 09/10 to 13/14. The previous five years IRE has been calculated with reference to actual costs incurred in 01/02 as reported in a proforma 'June Return' and the actual costs incurred in 06/07. The company has made an assumption for the intervening period (i.e. 02/03 to 05/06 inclusive) that expenditure has been made at a constant annual rate. The projected five year expenditure for 09/10 to 13/14 is based on the SBP prepared in 2007 which was based on the Northern Ireland Interim Asset Management Plan dated June 2002. The Company have noted in the commentary to tables 21 and 22 that their method of calculating IRC is a practical solution to limited data and as a result reduces the confidence level ascribed to the current IRC. This is also disclosed in the notes to the Regulatory Accounts.

9.3.2 The limited historical IRE information (dating back to a 'June Return' completed in 2001/2 by NI Water Service for the Department for Regional Development ('DRD'), which was subjected to review but not a full audit by an External Water Reporter), gives rise to uncertainties in determining the actual levels of IRE in the period since 2001/2. Management updated their estimates of actual IRE when preparing their Strategic Business Plan ('SBP') for submission and agreement with DRD prior to the set up of NIWL in 2006/7 – however as these were again based on limited historical information, and estimates of actual funding requirements for future periods to 2012/13, significant estimates and assumptions have been made by management in arriving at the Infrastructure Renewals Charge ('IRC') which is derived from the IRE information. NIWL have now put systems in place to enable detailed information on IRE to be captured and reported, which will facilitate historical trend data to be developed through time, and enable management to make increasingly sophisticated estimates of future IRC (and consequently more accurate estimates of IRC, which will be based on management's assessment of expenditure required to maintain the serviceability of the underground infrastructure).

9.3.3 An adjustment of £3.79m was made in the year to reduce IRC based on management's review of the forecasted IRE required to maintain the operating capability of the infrastructure asset. This was fully discussed between NIW, NIAUR and DRD. This assessment is supported by a review of the forecasted IRE by the Water Reporter who provided a statement to the company to this effect during the prior year.

9.3.4 Management have acknowledged the key components of their estimates of IRE and IRC in their commentary to table 21. We note that management estimates of IRE and IRC should become more robust in future years as more detailed historical trend analysis becomes available and the Company develops more sophisticated operational performance measurement systems.

9.3.5 We also note that management have not used the estimated IRE spend as set out in the PC10 submission in their calculation of IRC however this adjustment would be immaterial.

9.3.6 We note that no adjustment has been made to the regulatory accounts in order for IRE and IRC to agree (i.e. eliminating any prepayment or accrual) following managements' discussions with NIAUR. It has been agreed with NIAUR that the prepayment/accrual would be carried forward in accordance with the usual regulatory accounting guidance and that these figures would be examined at the next price control to determine whether the IRC was reasonable and to determine whether any future adjustment would be necessary.

9.3.7 We further note that the residual interest asset capitalised as part of the Omega and Kinnegar PPP projects is not broken down into its infrastructure and non-infrastructure elements due to a lack of available information. We recommend that management take the necessary action to enable the residual interest asset to be correctly classified as either infrastructure or non-infrastructure.

9.4 **Check that NI Water's explanation for the difference between the IRC reported in the Regulatory Accounts and the Statutory Accounts can be agreed to underlying accounting records.**

9.4.1 There is no difference between the IRC in the regulatory and statutory accounts.

10 Part H – Land Sales (Table 39)

[Part H – Land Sales has been redacted].

11 Part I – Analysis of borrowing (Table 19a)

11.1 **Confirm that the total carrying value of all instruments reconciles back to the appropriate line in table 19 as required by the reporting requirements of table 19a.**

11.1.1 The carrying value of £627,560k (per Part D Totals) has been agreed to table 19 line 20.

11.2 **Confirm that each instrument has been included within the correct category (A,B,C) in accordance with the definitions of FRS 26.**

11.2.1 Each instrument has been included in the correct category (A-C) in accordance with the definitions of FRS 26.

The capital loan notes have been classified as a fixed rate instrument under other borrowings (C).

11.3 **Agree the interest rates recorded in table 19a back to loan documents and other supporting documentation.**

11.3.1 The interest rate of 5.25% recorded for the capital loan notes has been agreed to the Fixed Coupon Unsecured Loan note 2027 agreement dated 1 April 2007.

We have noted that the interest rate of 5.25% relates to loan notes issued before 31 March 2010. Any loan notes issued after this date are subject to interest rates based on a margin of 0.85% above the reference gilt rate published by UK HM Government Debt Management Office. This amendment to interest rates has also been agreed to the loan note agreement and has been noted in the Company's commentary to Table 19a.

11.4 **Agree the hedging strategy to supporting documentation. Describe the nature of the supporting documentation.**

11.4.1 As per the statutory accounts, the Company does not adopt a hedging strategy.

11.5 **Review NI Water's commentary on any significant borrowings that mature in less than one year and agree the details back to supporting documentation.**

11.5.1 The Company does not have any significant borrowings which mature in less than one year.

12 Part J – General (Tables 42 and 43)

We note that management have amended the structure/format of Table 42 following discussions with NIAUR in order to make the disclosures more meaningful. Our commentary below refers to managements' final submitted table.

12.1 **Ensure that amounts recorded in tables 42 and 43 of the AIR10, as appropriate, are calculated in accordance with the terms of the relevant PPP contract and with Generally Accepted Accounting Practice (GAAP). Also review the audit trail for payment to PPP contractors and the checking of underlying evidence in support of these payments.**

12.1.1 The Company has three PPP contracts in place. For statutory accounts purposes Alpha is treated as an "on" balance sheet and Kinnegar and Omega are treated as "off" balance sheet. "On" balance sheet classification results in the fixed assets used in the contract being recognised on the balance sheet of NIW with an associated PPP creditor being recognised. An element of the unitary charge relates to the repayment of this PPP creditor balance. "Off" balance sheet classification results in the fixed assets used in the contract not being recognised on the balance sheet of NIW.

12.1.2 There is no difference between the statutory accounts and the regulatory accounts in terms of the "on/off" balance sheet classification of the PPP contracts.

12.1.3 The amounts recognised in the current year in respect of PPP contracts are in accordance with GAAP. Samples of payments were agreed, as part of our statutory audit procedures, to invoices from the PPP contractor and bank statements.

12.1.4 [Section 12.1.4 has been redacted].

12.2 **Details of any major control weaknesses identified from the review of PPP.**

12.2.1 [Section 12.2.1 has been redacted].

12.3 **Confirm values included in tables 42 and 43 are consistent with those in the statutory accounts and note any deviations.**

12.3.1 [Section 12.3.1 has been redacted].

12.4 **Review supporting commentary to table 42 with regard to NI Water statement on total PPP unitary charge. Review commentary to ensure consistency with underlying accounting records and the applicability of any assumptions made.**

12.4.1 [Section 12.4.1 has been redacted].

12.5 **Ensure that the amounts recorded in line 9 (Opex Deductions) of table 42 have been calculated and charged appropriately, promptly and accurately and are additionally consistent with the terms of the PPP contract between NI Water and the Concessionaire Company.**

12.5.1 [Section 12.5.1 has been redacted].

12.5.2 We noted during our statutory audit testing that the capital maintenance element of the Alpha PPP contract was not depreciated and whilst this is not material to the financial statements we recommended to management that depreciation should be charged.

12.6 **Ensure that any disputed amounts between NI Water and the Concessionaire Company have been treated and recorded appropriately in accordance with GAAP and the Regulatory Accounting Guidelines.**

12.6.1 [Section 12.6.1 has been redacted]

12.6.2 [Section 12.6.2 has been redacted].

12.7 **Check that any relevant efficiency gains recorded in line 10 of table 42 have been calculated accurately and applied consistently in accordance with the terms of the relevant PPP contracts.**

12.7.1 [Section 12.7.1 has been redacted].

12.8 **Additionally check the status of all efficiency audits and/reports on PPP operations and report on their implementation, where appropriate. Should implementation be outstanding report on the explanations provided by NI Water of any failure or delay in implementing such audits/report's.**

12.8.1 [Section 12.8.1 has been redacted].

12.8.2 [Section 12.8.2 has been redacted].

12.9 **Ensure that amounts recorded in lines 11 and 18 of table 42 for atypical expenditure and payments capitalised have been appropriately authorised and supported by information which supports the payments made.**

12.9.1 [Section 12.9.1 has been redacted].

12.10 **Confirm that all payments reviewed have been made in accordance with the terms of the relevant PPP contract or if such payments have been made outside the terms of the contract, that they have been appropriately authorised.**

12.10.1 We have agreed a sample of payments to bank statements and reconciled these to individual invoices provided by the contractor which have been checked and certified for payment by the Company.

12.11 **Confirm that all payments reviewed have been appropriately recorded and follow GAAP.**

12.11.1 All payments reviewed in relation to the PPP contracts have been appropriately recorded and follow GAAP.

12.12 **Check and report on the consistency of the total amount recorded in Table 42 line 20 and Table 43 line 4 with the respective totals recorded in line 21a of Table 21 and line 20a of Table 22.**

12.12.1 [Section 12.12.1 has been redacted].

12.13 **Check and report on the consistency of the total amount recorded in Table 43 line 5 with the total in line 22a of Table 21 and line 21a of Table 22.**

12.13.1 [Section 12.13.1 has been redacted].