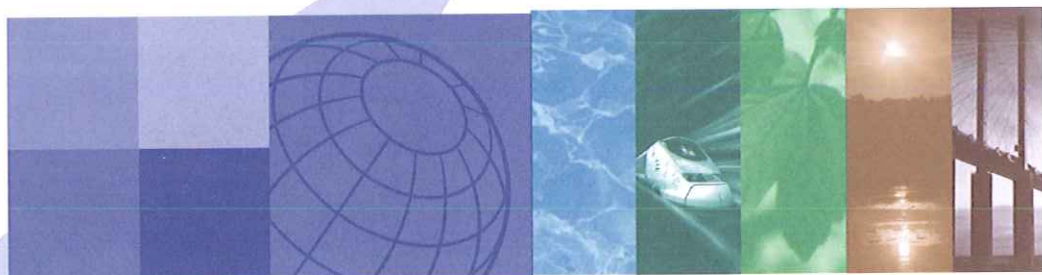


Northern Ireland Water Ltd
Annual Information Return 2010
To the
Northern Ireland Authority for Utility Regulation



Public Domain Version

Part 5 of 8 containing:
Regulatory Accounts - commentaries for tables 21, 22 and 25

Reporter's Submission

By

**CWJ Turner
Halcrow Management Sciences Ltd**

Halcrow

Table 21 and 22 – Activity Costing Analysis**Commentary by REPORTER****1. Background**

These tables collect information on operating costs and maintenance costs. The information from this table is used to identify trends in operating costs and also to derive annual unit cost comparisons

2. Key Findings

- The Company has applied a revised method to the completion of these tables for AIR10 compared to AIR09. The Company has also restated its submission for AIR09. The key difference relates to the treatment of general and support costs;
- We believe in general that the Company approach to the allocation of data is capable of reporting data in the appropriate format;
- Although the Company has restated the data for AIR09 and AIR10 the allocations between AIR09 and AIR10 have improved. This is responsible for some of the variations in data;
- For the current year the proportion of General and Support costs make up in the region of 33% of total costs whilst for equivalent companies in England and Wales the split is approximately 21% of general and support costs compared to direct costs. This variation could be due to differences in allocations as compared to England and Wales and inefficiencies within NI Water or a combination of the two;
- The Company has reported a number of atypical costs. These are discussed in more detail below. These costs have been included in general and support costs and customer services. We believe that these allocations could be improved;
- The Company has not disclosed in its commentary details of donations to charitable trusts or fines and provisions made against Section 74 of the Roads and Street Works Act. The Company advised that it has not incurred any such fines;
- The data relies on a combination of service activity code, expense code and responsibility code. In the majority of cases this should be sufficient to report data for the purposes of tables 21 and 22. However, it is possible that some costs will not neatly fit into the coding structure;
- The system relies on the correct coding of invoice and time costs;
- The process for completion of this table is documented at a high level. We received this document at the time of our audit.

3. Audit Approach

During our audit we reviewed the Company explanations for variations in costings. The Company has not limited its comment to the thresholds of 2% total opex and 30% sub-line opex being exceeded compared to the previous year as requested by the reporting requirements. In addition we have commented on the procedures used for cost

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

4. Audit Findings

4.1 NI Water Data

Method Non-PPP

As advised in the Company commentary a £3,000 de minimus figure is used for capitalisation. It should be noted that this relates to operational configurations which may consist of more than one item.

Data in tables 21 and 22 is based on information extracted from the General Ledger. All transactions within the General Ledger are coded to a cost centre with an associated Service Activity Code, Expense Type Code and Responsibility Code.

Together these allow for the reporting of information contained in table 21 and 22. The Company advised that the activity code and expense type code together allow for the identification of the majority of expenditure for lines in tables 21 and 22. The responsibility code is used to split expenditure in cases where costs are general costs such as customer services or scientific services.

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

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

In total more than 1,050 service activity codes and expense codes are used in order to record the data in the general ledger system.

Where the Company is not able to allocate expenditure using the activity code, expense type code and responsibility codes it uses a method based on direct costs to apportion costs.

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

Service Activity Code: The service activity code determines the type of work being carried out. It distinguishes between the water and sewerage service activities. Within the

water service it distinguishes between distribution and water treatment and resources. Within the wastewater service it distinguishes between sewerage, sewage treatment and sludge treatment. Further division of the service activity code within these subservice areas allows the Company to identify costs of particular activities. Particular service activity codes are used to capture costs of management, administration and support functions.

The service activity codes are shown below:

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

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

Expense Group	Description	Table 21 & 22 mapping
511X	Industrial Wages	1 Employment
513X	Other Wage Costs	1 Employment
514X	Other Costs of Employment	1 Employment
515X	Salaries	1 Employment
516X	Non-Industrial Expenses	1 Employment
517X	Temporary Support Staff	1 Employment
611X	Costed Wages Charge	1 Employment
612X	Wages Overheads	1 Employment
613X	Costed Wages Recovery	1 Employment
614X	Costed Wages Overhead Recovery	1 Employment
521X	Power	2 Power
531X	Operational Contractors	4 Hired and Contracted
532X	Other Contractors	4 Hired and Contracted
534X	Out sourcing	4 Hired and Contracted
538X	Consultants Fees	4 Hired and Contracted
541X	Materials and Equipment	6 Materials & consumables
544X	Non Operations Materials	6 Materials & consumables
547X	Stock Adjustments	6 Materials & consumables
548X	Chemicals	6 Materials & consumables
536X	Office and Computer Services	9 other direct costs
537X	Legal and other professional fees	9 other direct costs
551X	Accommodation	9 other direct costs
553X	Insurance - Premiums	9 other direct costs
553Y	Insurance - Claims	9 other direct costs
554X	Public Liability	9 other direct costs
555X	Employer's Liability	9 other direct costs
616X	Vehicle and Plant Charges	9 other direct costs
695X	Management Task	9 other direct costs
759X	Overheads Capitalised	9 other direct costs
518X	Staff Training & Hospitality	11 General & support
533X	V&P repairs	11 General & support
539X	Audit	11 General & support
546X	Mobile V&P Charges	11 General & support
552X	Communication	11 General & support
556X	Other Grants and Subscriptions	11 General & support
557X	Advertising and Publicity	11 General & support
641X	Intra Departmental Notionals	11 General & support
651X	Inter Departmental Notionals	11 General & support
775X	Discount Allowed	13 Customer services
556Y	Regulatory Costs	15 Other Business Activities
558X	Rates	17 Rates
772X	Bad Debts	18 Doubtful debts
534Y	PPP	20/21a PPP unitary charge

Responsibility Code: The Company advised that all cost centres within the general ledger system have responsibility codes associated with them. Thus all transactions

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

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

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

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

We did however challenge the Company on the use of the responsibility coding process, as the Company has service activity descriptions that relate to customer service and scientific services. We challenged the Company as follows:

‘Your service activity descriptions provide for data to be coded to both scientific services and customer services. Why then is it necessary to report customer services and scientific services costs on the basis of responsibility codes?’

The Company advised that *‘There are generic service activities which can be used by Customer Services, Scientific Services and Other areas of the Business, therefore the responsibility code is necessary to specifically isolate the CS and SS costs..’*

4.2 Allocations by Line - NI Water

Employment Costs

The process relies on the completion of timesheets that use a mix of service activity and expense code for direct operations staff. For non-direct operations staff expenditure is assigned on the basis of responsibility codes.

Remaining Direct Costs

The process relies on the correct coding of invoices to a mixture service activity code and expense code.

General and Support Expenditure

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

For AIR08 the Company had reported in excess of £50 million for General and Support costs. For AIR09 the Company advised that it considered the £50 million to be an inflated view of the actual costs that should be General and Support. It therefore undertook a separate exercise to determine AIR09 general and support expenditure.

This resulted in general and support costs reducing by more than 70% to less than £13 million. Our review suggested that this resulted in too great an adjustment. As a result we felt that the general and support costs reported in AIR09 were understated.

For the report year, NI Water has reverted back to the methodology used in AIR08. It has however undertaken discussions with the regulator related to the types of costs that should be reported in General and Support costs. It has also provided a restated AIR09 table 21 and 22 based on the revised method.

For the report year general and support costs have been split on the following basis:

Allocation of General and Support	Water		Sewerage		
	R&T	Distribution	Sewerage	Sewage Treatment	Sludge Treatment & Disp
G&S Overhead Pot 1	21.2%	22.1%	19.0%	20.9%	16.7%
G&S Overhead Pot 2a - Water	48.9%	51.1%	0.0%	0.0%	0.0%
G&S Overhead Pot 2b - Sewerage	0.0%	0.0%	33.6%	36.9%	29.5%
G&S Overhead Pot 3	21.2%	22.1%	19.0%	20.9%	16.7%

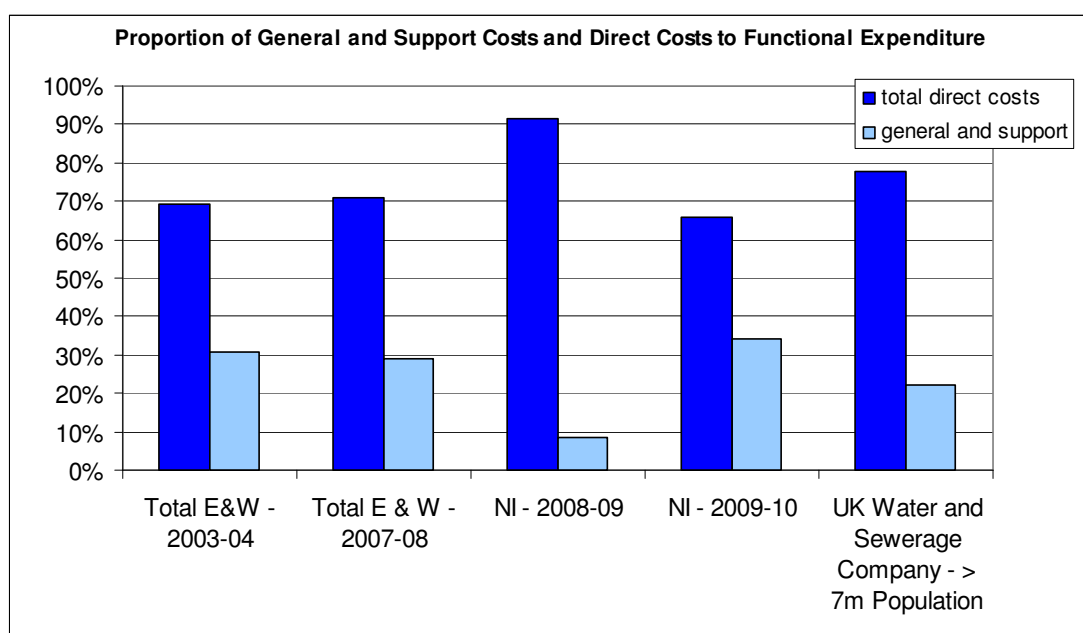
The total value of general and support costs allocated at the time of our audit was in the region of £39 million. Of these the largest portion of costs are allocated to General and Support Overhead pot 1, which accounts for more than 96% of the costs. General and Support overhead pot 2a accounts for about 3%, whilst the remainder is in General and Support costs pot 2b. General and Support costs in pot 3 are marginal and negative.

Overhead pot 1 relates to non-specific General and Support costs. These have been split across the service activities and by service on the basis of calculated total direct costs. Overhead Pot 2a and 2b relate to overheads for water and sewerage spend. These costs have been pro-rated on the basis of total direct costs within each of water and sewerage cost categories. Overhead Pot 3 relates specifically to networks functions activity.

Again, the Company has split this against each service activity on the basis of total direct costs. As these overheads relate specifically to network activities it may be more appropriate to split this expenditure against distribution and sewerage. We challenged that these costs should be reported only as network activity costs. The Company advised that these costs related to only -£5,000 and hence these costs are not material.

We note that Voluntary Early Retirement has been allocated as a general and support costs. We believe it would be more appropriate to report this elsewhere.

Figure 1 below demonstrates the split of G&S expenditure compared to total direct costs for NI Water for 2008/09¹ and 2009/10. In addition it provides a comparison of General and Support costs in England and Wales. As the guidelines are the same it would be reasonable to expect the split of costs between NI Water and England and Wales to be broadly similar. However, as the figure below shows, general and support expenditure still exhibits some variation compared to England and Wales.



We believe that some of this variation is due to variation in methods for reporting this data between England and Wales and NI Water. This would impact on any comparison of NI Water with England and Wales data.

In relation to allocations we have reviewed the method provided by the Company for completion of this table. The method does not provide detail at individual cost centre level on the allocation of costs to general and support and direct costs. We did note, during our discussions with the Company that Severance Costs for the year totalling £5.1 million have been allocated to general and support costs.

¹ It should be noted that the comparison relates to the original submitted return and not the restated 08/09 return.

In order to improve the quality of reported data and ensure data is reported consistently between years a more detailed costing manual detailing costs that are allocated as general and support should be created and agreed with the regulator.

Operating Expenditure

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

		Water	Sewerage	Total
Customer Services		44.2%	55.8%	100.0%
Scientific Services		44.2%	55.8%	100.0%
Other Business Activities		44.2%	55.8%	100.0%
Rates		48.0%	52.0%	100.0%
Doubtful Debts		58.4%	41.6%	100.0%
3rd Party expenses		96.1%	3.9%	100.0%

The 44.2% - 55.8% split above is based on total direct costs between water and sewerage.

The split for rates is based on actual invoices. The split for doubtful debts is based on total operating revenue and the portion of operating revenue from water and sewerage services.

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

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

Customer Services

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

We challenged the Company in relation to the possibility of service managers sharing responsibility across different areas such as customer services and debt recovery for example, or customer services and other business activities such as regulatory services. The Company advised that *'There is a possibility, but the financial implications are deemed to be immaterial.'*

[x]

Scientific Services

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

Other business activities

The Company advised that this is regulatory costs. These are identified by responsibility code H160. The total cost for water and sewerage for other business activities is reported as £5.2 million. The Company advised that this is the cost of Reporter activities and the fees imposed by the regulatory authority. The costs of the NI Water regulatory team has been stripped out of employment costs and reported under regulatory reporting services.

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

Rates

The Company advised that the value for rates is based on actual invoice data. The process again relies on the correct coding and recording of these within the General Ledger system.

Doubtful Debts

Data related to doubtful debts is extracted from the Company systems. The basis of the split between water and sewerage is described above.

Exceptional Items

The Company has not reported any exceptional items. A number of items have been recorded as atypical. These are described in the Company commentary.

Third Party Service - Opex

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

Total PPP Unitary Charges

[x]

Reactive and Planned Maintenance Infrastructure

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

Reactive and Planned Maintenance Non-Infrastructure

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

4.3 Allocation of costs to un-appointed activities

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

4.4 Reorganisation costs

The Company has provided the following split related to re-organisation costs.

Description	Amount	Table 21/22 location
Business Improvement programme	£6.4M	General & support – all activities
[x]	[x]	[x]
Voluntary Early Retirement Scheme \ Voluntary Severance (VER \ VS)	£5.1M	General & support – all activities
Total	[x]	

Last year, reorganisation costs of £22.8 million were reported. The basis of the allocation of these costs has however changed. In previous years the business improvement programme was split according to the areas that were impacted, whilst the VER/VS costs were allocated to employment costs.

[x]

[x]

[x]

[x]

For AIR10 we challenged the Company in relation to the basis of allocation of the Voluntary Early Retirement Scheme and Voluntary Severance costs to general and support costs. The Company advised that it would review this allocation in AIR11.

4.5 Fines and Donations

NRSWA Fines

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

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

The Company has not reported any donations to charitable funds for the current report year.

4.6 Exceptional Items

The Company has not reported any exceptional items for 2009/10.

4.7 Atypical Costs

The Company has reported a number of atypical costs in relation to tables 21 and 22. The categories are as follows:

- Additional expenditure of £0.5 million related to hired and contracted services to address the prolonged adverse weather conditions during December 2009 and January 2010.
- Reorganisation costs: These are discussed above.
- Business Improvement Programme: These are discussed above.
- [x]
- Voluntary Early Retirement: This is discussed above.

4.8 AIR10 Key Cost Drivers

In total for water and sewerage there has been a movement in functional expenditure of a reduction of £21 million. This compares data with the restated table 21 for 08/09 rather than the original table for 08/09.

The Company advised the following fluctuations for the two years:

EXPENSE GROUP	£	Company Commentary Reference
(1) Staff costs	£4m	Pg 6 – Staff costs
(2) VER & Pension costs	£9m	Pg 5 VER under Atypical costs – £7m VER Pg 18 Pensions – £2M
(3) Mechanical & Electrical costs	£2m	Pg 8 – General & Support Costs
(4) Business Improvement costs	£2m	Pg 4 – Atypical costs and provisions: Business Improvement
(5) Public Liability costs	£4m	Pg 8 – An element of the unallocated Other Direct Costs
<u>TOTAL</u>	<u>£21m</u>	

These items are discussed individually below:

- 1) The Company commentary describes the reduction as £4million due to reduced staff employed by NI Water. We are aware of the severance programme.
- 2) Page 5 discusses the variation in VER accruals between the two years. In 2008/09 the VER accrual was £11.7 million, whilst for 2009/10 it is £5.1 million. The difference being a reduction of circa £7 million. It is not clear where the reduction in £2million related to pensions is described in the Company commentary.
- 3) The variation in mechanical and electrical costs has not been explicitly addressed in the Company commentary. We challenged the Company in relation to whether electrical and mechanical costs follow a de-minimis rule for capitalisation similar for other items of categories of expenditure. The Company advise that this was the case.
- 4) The Company commentary describes the variation in business improvement costs between 2008/09 and 2009/10.
- 5) The variation in public liability costs is not addressed explicitly in the Company commentary.

4.9 Table 21 Specific Lines

The Commentary below compares the restated AIR09 Table 21.

A – Direct Costs

Line 1

The Company report that there has been a reduction in employment costs in both water resources and treatment and water distribution. This is attributed to an overall reduction in staff numbers.

Line 2

The Company advised that it has experienced an increase in the unit cost of 5% for the current year on the fixed element of the unit price. This is assigned as the main reason for the increase in power costs. We note, from the data provided to us, that the NI Water power costs reported in table 21 have reduced. We also note that over the same period there has been a reduction in domestic electricity prices for the report year of 2.5%.

Line 3

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

Line 4

The variation in Hired and Contracted service is advised as £1.7m. The Company attribute this variation to the costs of the 'Freeze Thaw' caused by the unusually cold weather in the winter of the report year. We believe this is a reasonable explanation. Extreme cold weather is likely to impact on the number of leaks and hence the cost of repair.

Line 5

The Company has not reported any costs for associated companies for the current year.

Line 6

A variation of -£0.9 million exists in costs. This consists of water resources and treatment costs of -£0.4 million per year due to decreased usage of chemicals. A reduction in water distribution costs of -£0.5 million is attributed to better stock control and the contractor undertaking more new connections.

Line 7

The Company has not reported any costs in this line.

Line 8

The Company has not reported any costs in this line.

Line 9

The Company advises that a variation in costs of £0.5 million exists. The reduction in Water Resources and Treatment has been mainly attributed to efficiencies due to reduced vehicle and plan costs. Water distribution has a negative figure reported. This is because data is reported net of income from new connections.

Line 10 - Total Lines 1 - 9

This is the sum of lines 1-9. The total value is equal to the sum of the data in the PPP table and the sum of the data in the NI Water table.

Line 11

As compared to the restated table, General and Support costs for NI Water have reduced

by more than £11million for table 21. The Company attributes this reduction to various factors including:

- Significant reduction in VER costs;
- Reduced pension costs;
- Reduction in BI costs;
- Reduction in M&E costs;
- Other efficiencies and improved allocations.

We have expressed some doubt about the allocation of severance costs, Business Improvement and M&E expenditure to general and support expenditure. We challenged the Company as follows:

'Would it be more accurate to assign severance costs, business improvement costs and steria termination costs as exceptional items instead of reporting these costs in general and support expenditure and customer services?'

The Company advised that:

'The specific costs mentioned have been treated and highlighted as atypical costs in the commentary. There have been no exceptional costs reported in NIW's statutory accounts in line with FRS 3.'

It is not clear why an improved allocation has been highlighted as a reason for the variation of data between the two years. This is because the AIR09 table has been restated using the AIR10 method. We challenged the Company in relation to this. The Company advised that although 'AIR10 and restated AIR09 were created on the same basis however the individual allocations have improved.'

In order to understand the underlying fluctuations in general and support costs, one-off costs need to be removed, whilst a stable allocation method needs to be established.

Line 12

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

B - Operating Expenditure

Line 13

The Company advised that Customer Services costs have increased slightly due to the termination of a Customer Services contract. We challenged the Company about specifically which areas of its customer services functions had been impacted. The Company advised that the customer services directorate has been impacted.

For the current year the Company has allocated costs between tables 21 and 22 on the basis of direct costs. The percentage of total direct costs, (lines 10 and 9 for water and

sewerage respectively) is shown below:

Service Area	Percentage
Water	44.2%
Sewerage	55.8%

In AIR09 the split used was 45.7% and 54.3% between water and sewerage.

We believe that the use of total direct costs is appropriate in order to split this expenditure between water and sewerage services.

Line 14

The Company advises a marginal variation in scientific services costs between the restated AIR09 and the AIR10. Scientific services are split on the same basis as customer services above.

Line 15

Line 15 relates to other business activities. The Company has advised that the following cost categories exist here:

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

The Company advised that costs have reduced slightly due to reduced regulator fees for the report year.

The Company has again used the direct cost split described above.

Line 16

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

Line 17

This relates to local authority rates. The Company advised that local authority rates have increased slightly in AIR10 due to the increase in non-domestic council tax rates.

Line 18

This relates to doubtful debts payments. The Company reported an increase in bad debts last year which was mainly due to a one-off write-off in respect of bills issued on test meters. For the report year doubtful debts have reduced by £1.5 million. The basis of the split is discussed above. The Company has highlighted its close working with the external billing supplier in the reduction of non-domestic debt.

Bad debt policy and the allocation of provisions fall within the domain of the financial auditors.

Line 19

The Company has reported zero in line 19 for exceptional items.

Line 20

This is a calculated line.

Line 21

The Company reports a marginal increase of less than £0.1m. This is attributed to a change in rechargeable works.

Line 21a

The Company has reported zero for this line.

Line 22

Line 22 is total operating expenditure. This is a calculated line.

C - Reactive & Planned Maintenance*Line 23*

This line relates to infrastructure maintenance. The Company has advised that this figure has reduced due to further improvements in coding by the operational staff throughout the Networks Water Function. We understand that this is due to better education and understanding of the coding system by budget holders.

Line 24

This line relates to non-infrastructure maintenance. The variation in the report year is not material.

4.10 Table 22 Specific Lines

The Commentary below compares the restated AIR09 Table 22.

A – Direct Costs*Line 1*

The Company report a reduction in employment costs for both sewerage and sewage treatment of £0.6 million and £1.3 million respectively. This is attributed to the overall reduction in staff numbers.

Line 2

The Company has reported a reduction in sewerage power costs of £0.3 million. For sewage treatment and sludge treatment and disposal the Company has reported an increase in power costs of £0.7 million and £1.0 million respectively. The Company advise that the increase in costs is due to a 5% increase in the fixed price element of the unit price for electricity.

The Company has allocated power costs based on Wastewater Field Managers information related to percentage estimates of power costs between sewage treatment and sludge treatment at each of the WWTWs where both activities exist. The views are based on an internal judgement. This is the same approach as that used for AIR09.

Line 3

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

Line 4

Hired and contracted services have increased by £0.6 million. The main increase relates to £0.5m for sewage treatment.

Line 5

The Company has not reported any costs for associated companies.

Line 6

Materials and consumables have increased by circa £0.1million for sewerage. This has been offset by a reduction in sludge treatment and disposal of an equivalent amount.

Line 7

The Company has not reported any costs in this line.

Line 8

A small reduction in costs of £0.2 million is attributed to efficiency savings due to rationalisation of vehicles and plant.

Line 9 - Total Lines 1 - 8

The total value is equal to the sum of the data in the PPP table and the sum of the data in the NI Water table.

Line 10

As compared to the restated table, General and Support costs for NI Water water have reduced by more than £7million for table 22. The Company attributes this reduction to various factors including:

- Significant reduction in VER costs;
- Reduced pension costs;
- Reduction in BI costs;
- Reduction in M&E costs;
- Other efficiencies and improved allocations.

We have expressed some doubt about the allocation of severance costs and M&E expenditure to general and support expenditure as described in our commentary to table 21.

We also believe a case exists for reporting Business Improvement costs as exceptional items in order to allow appropriate comparison of annual expenditure fluctuations.

In order to understand the underlying fluctuations in general and support costs, one-off costs need to be removed, whilst a stable allocation method needs to be established to determine the correct underlying trend in general and support costs.

Line 11

This is a calculated line.

B - Operating Expenditure

Line 12

[x]

For the current year the Company has allocated costs between tables 21 and 22 on the basis of direct costs. The percentage of total direct costs, (lines 10 and 9 for water and sewerage respectively) is shown below:

Service Area	Percentage
Water	44.2%
Sewerage	55.8%

We believe that the use of total direct costs is appropriate in order to split this expenditure between water and sewerage services.

Line 13

Line 13 relates to scientific services costs. A slight variance exists in scientific services for AIR10 compared to the restated AIR09. The split used between water and sewerage is the same as that used for customer services.

Line 14

Line 14 relates to other business activities. The Company has advised that the following cost categories exist here:

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

The Company advised that costs have reduced slightly due to reduced regulator fees for the report year. The Company has again used the direct cost split described above.

Line 15

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

Line 16

This relates to local authority rates. We note an overall change in rate costs of £1.1 million. The Company advised that the increase is due to the increase in the number of works that are covered by the rates bills.

The Company advised that it has taken actual payment data specific to waste which can be identified from the rates bill. The Company advised that the process is the same as that used for AIR09.

Line 17

NI Water reports a reduction in total doubtful debt payments as compared to the AIR09. The basis of the split between water and sewerage is discussed above. The Company has highlighted its close working with the external billing supplier in the reduction of non-domestic debt.

Bad debt policy and the allocation of provisions fall within the domain of the financial auditors.

Line 18

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

Line 19

This is a calculated line.

Line 20

Third party services are rechargeable works. The Company has reported a reduction in costs of £30,000 resulting in a reduction of third party service to £9,000.

Line 20a

Line 20a relates to the PPP Unitary Charge (Opex element). The Company has reported £1,000 in this line.

Line 21

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

C - Reactive & Planned Maintenance

Line 22

This line relates to infrastructure maintenance. The Company has advised that this figure has reduced slightly due to further improvements in coding by the operational staff throughout the Networks Water Function. We understand that this is due to better education and understanding of the coding system by budget holders

Line 23

This line relates to non-infrastructure maintenance. The variation in the report year is not material.

5. Infrastructure Renewals Charge (IRC)

See Commentary for Table 33.

6. System Controls

An internal audit at AIR08 provided recommendations regarding sign offs, password protection of files and process notes. These procedures have been incorporated in the Company process where possible.

7. PPP Data Table**General**

For the current year PPP facilities have continued to come on line. The Kinnegar contract has been providing services for a number of years. The sites at Alpha were all fully operational prior to the current report year. The Omega contracts have some outstanding sites. The Duncrue site became operational on the 31st March 2010 whilst the Ballynacor site is not yet operational. Omega consists of 2 sludge services sites and 5 sewerage sites as well as a sludge remediation site.

Method PPP

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

- [x]

- [x];

- [x].

Variation from Previous Years

Cost increases from previous years are expected as more PPP sites go online.

7.1 Table 21 – Specific Lines*Line 2*

The power costs here relate to water resources and treatment for the Alpha contract. The Alpha contract only provides potable water. Costs have increased in the region of 180%. The total power cost figure is £6.473 million compared to £2.32 million reported last year. The reported costs reflect a full year of the power attributed to Alpha services in this reporting period compared to less than 4 months of the services in AIR09 period.

As the costs are coded individually within the Company system for large site power costs, data has been extracted from the general ledger oracle system.

Line 11

The Company has reported a total of £234,000 in this line. This is an increase of more than 215% on the figure reported at AIR09. The increase is consistent with increased PPP works coming online. NI Water advised that in AIR09 the Company reported on the costs of administering the Contracts in service, but not in construction. The Company further advised that the increase in G&S costs reflects (i) almost all sites in Service; and (ii) a revised method for apportioning the G&S costs to specific facilities in service in each PPP contract as demanded of Table 42.

The analysis is based on an assessment by the Company of the number of staff employed within the PPP contract administration function. Not all staff are employed full time on PPP related activities. Similarly not all PPP contracts are fully active. The Company analysis relies on management judgement of where to allocate payroll costs of staff. We believe it is a simplification. However, in the absence of direct timesheet data we believe this an appropriate method of apportioning these costs. In addition any consulting costs incurred for this contract are included here.

Line 17 Rates

Rates cost of £2.835 million have been paid for the current year. We challenged the Company in relation to why there were no rates costs for AIR09. The Company advised that PPP AIR09 did not ask for these costs to be reported.

Line 21a PPP Unitary Charge

[x]

[x]

[x]

7.2 Table 22 – Specific Lines

Line 2

The Company has reported £1.1 million for power costs. These relate to the Omega Facilities only and not Kinnegar. The increase reflects the additional sites that have become operational in the report year. Costs have not been reported for sludge disposal and the transport of sludge has no associated costs.

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

Line 10

The Company has reported a total of £1.1 million of general and support expenditure. This is close to a six-fold increase on the figure of £158k reported in AIR09. This is attributed to the increased works that are operational.

The Company undertook analysis to split general and support costs between the different contracts managed by NI Water. The analysis relied on management judgement to split works that provided both sewage treatment and sludge treatment and disposal. Although this is a simplification, in the absence of actual data we believe the method is appropriate.

The Company allocates payroll cost of FTE's across the different contracts based on management judgement. In addition we note consultancy costs of £1.1 million across the three PPP sites. The Company advised that the figure includes the significant temporary consultancy support in managing the construction interface on Project Omega throughout the AIR10 reporting period and is not indicative of the consultancy support costs required for the contract administration of the PPP's in service. The consultancy costs are allocated on a cost centre basis and therefore are actual consultancy costs incurred on each of the contracts.

Line 13

For the current year the Company advise that it has provided a number of tests as contractually obliged under the Omega and Kinnegar contracts. This included tests related to suspended solids and determination of oxygen demand for processes. The overall variation is a cost reduction of 14% in nominal terms. We challenged the Company in relation to information provided last year about reporting information for the Kinnegar contract only, whilst for Omega this formed part of the charge. The Company advised that scientific services costs for Omega were included in scientific

services costs in AIR09.

In addition the Company advised that the value compared to last year had reduced due to an error in the assessed number of samples for AIR08.

Line 16 Rates

Rates cost of £487k have been paid for the current year. This is based on the actual rates bill which can be identified by site. We challenged the Company in relation to why there were no rates costs for AIR09. The Company advised that PPP AIR09 did not ask for these costs to be reported.

Line 20a PPP Unitary Charge

[x]

Further information in relation to actual cash payments and accounting procedure for recording the payment as an operating charge should be referred to the Company Financial Auditors.

Date: 30 July 2010
Prepared By: [x]

Table 25 - Analysis of fixed assets by asset type

Commentary by REPORTER

1. Key Findings

The Company advised that it has not made any AMP adjustments in this table for AIR10.

Date: 30 July 2010
Prepared By: [x]