



**Northern Ireland Water Limited**

**Auditors' Report and  
Commentary on the Annual  
Information Return  
Year ended 31 March 2011**

29 July 2011  
This report contains 39 pages  
See Notice about this Report on page 1



## Contents

|    |  |    |
|----|--|----|
| 1  | Notice about this report   | 1  |
| 2  | Report of the Independent Auditors to Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation | 2  |
| 3  | Part A – General Procedures  | 4  |
| 4  | Part B – Activity Cost Analysis (Tables 21 & 22)   | 12 |
| 5  | Part C – Pensions (Tables 18, 18a, 18c, 18d, 19, 20, 21, 22 & 24)  | 16 |
| 6  | Part D – Income (Tables 23 and 26)   | 19 |
| 7  | Part E – Bad Debt (Tables 6a, 21 and 22)   | 22 |
| 8  | Part F – Taxation (Tables 18a and 18b)   | 31 |
| 9  | Part G – Accounting Charges (Table 33 & 34)  | 32 |
| 10 | Part H – Land Sales (Table 39)   | 35 |
| 11 | Part I – Analysis of borrowing (Table 19a)   | 36 |
| 12 | Part J – General (Tables 42 and 43)  | 37 |



## 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 2010.
- 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', 'FAR' and 'Echo'. Oracle is the accounting system used by NIWL, Rapid Xtra is the billing system, FAR is the fixed asset register 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 2011 were approved by the Board of Directors and signed on 6 July 2011. The Regulatory Accounts for the year ended 31 March 2011 were approved by the Board of Directors and signed on 6 July 2011.
- 1.1.8 This report should be read in conjunction with the Annual Information Return prepared by NIWL for the year ended 31 March 2011.
- 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 2010 (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 31 March 2011 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.



**Emphasis of matter in respect of the basis of valuation of tangible fixed assets**

The accounting policies to the Regulatory Accounts set out details in respect of the current cost basis of valuation of tangible fixed assets. We draw your attention to the fact that the valuation is not based on a Modern Equivalent Asset Value (MEAV) as required by the Regulatory Accounting Guidelines. Our opinion is not qualified in this regard.

**Opinion**

Based upon our view, in our opinion, the Regulatory Accounts tables contain the information for the year to 31 March 2011 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  
29 July 2011

### 3 Part A – General Procedures

Requirement (in bold 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 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) and note the introduction of a specific process to allocate each individual table to one owner. We do note however that certain tables provided for audit were initially incomplete due to the tables being populated by different individuals. Whilst we recognize that this arose in the current year due to time constraints we recommend that each table is assigned to one individual wherever possible and is fully quality assured prior to being passed for audit.

3.1.2 Each table 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 Finance and Regulation Directorate (“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 2011 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 15 July 2011, the Board approved the text of the AIR 2011’s Board overview and agreed submission of all final AIR11 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**

No issues noted.

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. Management have advised in their commentary that 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 to reflect the fact that only the element of the pension asset relating to the Northgate service should have been accounted for rather than the entire service of these employees. We do note however that the number of employees, and associated pension assets, are very small.

3.2.6 **Part D Income**

We note that management have taken steps in the current year to enable a comparison between accrued and billed income and as such identified further adjustments required, however management acknowledge that this process is in its early stages and further work is required to develop this process. The process developed in the year has allowed management to assess, to a certain extent, the accuracy of accrued income and show 'the actual income billed compared to the amount accrued in the previous year'.

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:

- Matching of credit balances to outstanding debt.

3.2.8 We recommend that management take action to resolve the issues identified in 3.2.7 above with particular focus on the matching of credit balances to outstanding debt. 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**

[Sections 3.2.10 to 3.2.16 have been redacted]

### 3.2.17 **Part G Accounting Charges**

During our statutory audit work we identified an issue in respect an adjustment relating to assets not in use at the date of the transition from the Water Service to Northern Ireland Water Limited. As a result of this identification management reallocated the adjustment between existing assets resulting in a decrease to Water assets in the amount of £12.7m and an equivalent increase in Sewerage assets.

### 3.2.18 **Part H Land Sales**

[Section 3.2.18 has been redacted]

### 3.2.19 **Part I Borrowings**

No exceptions noted.

### 3.2.20 **Part J General**

[Section 3.2.20 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.**

[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 10/11 accounts relate to the audited statutory and regulatory accounts for the year ended 31/03/11.

| 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 10/11. We have agreed lines 29, 31, 33, 43, 45, 47, 57a and 58a (for 10/11) 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 2011. Household numbers in lines 30, 32 and 34 have been provided by the Rapid Xtra billing System. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return. |
| Table 18 | Profit and Loss Account (Historical Cost Accounting)                         | We have agreed lines 1 to 15 (for 10/11) to the 10/11 Regulatory Accounts, to the Oracle nominal ledger and client schedules detailing adjustments made for regulatory purposes.  |

| Table     | Description  | Comment   |
|-----------|--|---|
|           |  | Comparatives (for 09/10 and 08/09) have been agreed to the 2010 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 10/11) to the 10/11 Regulatory Accounts. The actuarial gain reported in line 2 has been agreed to the Statutory Accounts. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 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 £70,450k 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 10/11 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 09/10 and 08/09) have been agreed to the 2010 Annual Information Return. |
| Table 19  | Balance Sheet (Historical Cost Accounting)                                       | We have agreed lines 1 to 33 (for 10/11) to the 10/11 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 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 09/10 and 08/09) have been agreed to the 2010 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 10/11 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.  |

| Table    | Description  | Comment  |
|----------|--|--|
| Table 20 | Profit and Loss Account<br>(Current Cost Accounting) | <p>The years to maturity has been agreed as the number of years from 31 March 2011 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.</p> <p>We have agreed lines 1 to 16 (for 10/11) to the 10/11 Regulatory Accounts, to the Oracle nominal ledger and to client supporting schedules detailing adjustment made for regulatory purposes. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.</p>   |
| Table 21 | Activity Cost Analysis –<br>Water Services           | <p>We have agreed lines 1 to 34 (for 10/11) to the 10/11 Regulatory Accounts except for lines 16, 23 and 24 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts.</p> <p>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.</p> <p>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.</p> <p>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 agreed as being the sum of the NIW only table and the PPP only table.</p> |
| Table 22 | Activity Cost Analysis –<br>Sewerage Services        | <p>We have agreed lines 1 to 33 (for 10/11) to the 10/11 Regulatory Accounts except for lines 15, 22 and 23 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts.</p> <p>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.</p> <p>The sum of the total of lines 24-26 in table 22</p>  |

| Table    | Description                               | Comment  |
|----------|---|--|
|          |   | <p>and lines 25, 26 and 27 in table 21 have been agreed to the Oracle nominal ledger and current cost fixed asset register.</p> <p>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.</p>   |
| Table 23 | Analysis of Turnover and Operating Income | <p>We have agreed lines 1 to 21, with the exception of line 7a (for 10/11) to the 10/11 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 09/10 and 08/09) have been agreed to the 2010 Annual Information Return. However, certain comparatives for 09/10 in respect of lines 2, 5 and 7 have been restated (as instructed by the regulator), to enable meaningful comparison by classifying certain income with the large user category.</p> |
| Table 24 | Balance Sheet (Current Cost Accounting)   | <p>We have agreed lines 1 to 29 (for 10/11) to the 10/11 Regulatory Accounts, the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.</p>   |
| Table 25 | Analysis of Fixed Assets by Asset type    | <p>We have agreed lines 1 to 16 (for 10/11) to the 10/11 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.</p>   |
| Table 26 | Working Capital                           | <p>We have agreed lines 1 to 13 (for 10/11) to the 10/11 Regulatory Accounts and supporting mapping schedules from the Oracle nominal ledger. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.</p>   |
| Table 27 | Movement on Current Cost Reserve          | <p>We have agreed lines 1 to 7 (for 10/11) to the 10/11 Regulatory Accounts except for line 3 which is the sum of £382,526k (Fixed asset RPI adjustment) and £79k (current cost loss on</p>  |

| Table    | Description   | Comment  |
|----------|---|--|
|          |   | disposal of fixed assets) featured in the Regulatory Accounts. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.  |
| Table 28 | Cash Flow Statement   | We have agreed lines 1 to 23 (for 10/11) to the 10/11 Regulatory Accounts and client workings based on the Statutory Accounts. Comparatives (for 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.  |
| Table 29 | Reconciliation of Operating Profit to Net Cash Flow                     | We have agreed lines 1 to 9 (for 10/11) to the 10/11 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 09/10 and 08/09) have been agreed to the 2010 Annual Information Return.  |
| Table 30 | [Redacted]  | [Redacted]   |
| Table 31 | [Redacted]  | [Redacted]   |
| Table 33 | Depreciation charge by asset type                                       | We have agreed the depreciation charge for the year for both Water and Sewerage to the Regulatory Accounts. We are unable to agree lines 1, 4 and 5 to the Regulatory Accounts as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts. The total IRE and IRC charge have been agreed to the Regulatory Accounts, with the cumulative balance being recalculated based on the actual IRE charge and the charge within PC10. Comparatives (from 2007-10) have been agreed to the 2010 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 6 July 2011, 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 2011 figures. We do note however that the prior year adjustment in respect of the restatement of deferred taxation that has restated the 2010 comparative figures in the regulatory accounts has not been reflected in the 2010 comparative figures in the current 2011 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 10 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 11 commentaries.
- 3.8 **The full wording of the opinion NIAUR require for the Regulatory Accounts for 2010/11 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. We have however included an emphasis of matter paragraph in our audit opinion on the regulatory accounts in respect of the basis of valuation of tangible fixed assets.
- 3.8.2 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. We have also included an emphasis of matter paragraph in our audit opinion in respect of the basis of valuation of tangible fixed assets.
- 3.9 **NIAUR expect, given the timescales of submission for the Annual Information Return 2011, 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.

## 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) - £3.4m
- Bad debt charge (10% of £1.67m) - £167k
- 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 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.

4.1.3 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.

4.1.4 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.

**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 have been no changes in the methodology with respect to the calculation of direct and general and support costs.

**4.3.2** Operating expenditure costs from the general ledger have been allocated between Water and Sewerage services and between service areas within the Water and Sewerage activities by mapping the company's general ledger to the tables using the coding structure described in managements' commentary to tables 21 and 22. The only exception to this is in relation to indirect general and support expenditure which can relate to more than one service area or activity. These costs are collated into four separate 'overhead pots' and are apportioned either on the basis of directly coded spend or on the basis of total direct costs. Whilst the level of the apportionment of the general overhead pots has not changed significantly from AIR 10 to AIR 11, the allocation to Water from general and support has increased from approximately 43.3% to 51.1% largely as a result of the increased direct costs relating specifically to Water. These are primarily driven by the transfer of the Incinerator to PPP, reducing Sewerage costs and the impact of the freeze/thaw incident.

**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 of atypical expenditure. The freeze/thaw incident in December 2010/January 2011 which lead to expenditure of approximately £5.1m. In addition £2m of costs were incurred under the Business Improvement Programme and £2.6m of costs were incurred in respect of voluntary early retirements/voluntary severance. No exceptional items have been identified. We also note that management have included a generic commentary in respect of claims arising from contractual arrangements with suppliers. The costs have been supported by management assessment and agreed to underlying accounting records including invoices, correspondence with employees, and correspondence with the company's actuary. The table below sets out the atypical costs in respect of the business improvement programme and VER/VS costs over the past three years:

| Category                               | 2007/08 (£m) | 2008/09 (£m) | 2009/10 (£m) | 2010/11 (£m) |
|--|--------------|--------------|--------------|--------------|
| Business improvement                   | 8.1          | 8.4          | 6.4          | 2.0          |
| Voluntary severance / early retirement | 4.56         | 11.7         | 5.1          | 2.6          |

We note that the items of atypical expenditure set out above, and included in managements' commentary, is based on the final determination provided by NIAUR.

**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 The threshold at which expenditure is classified as capital changed from 1 April 2010 from £3,000 to £1,000. With this exception 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. Sampling of expenditure on capital projects performed during the statutory audit fieldwork confirmed that the policy in place during the 2010/2011 financial year was applied. Additionally audit testing performed during the statutory audit fieldwork identified several internal control matters with regard to fixed assets that have been communicated to management in the 2011 board report.

These issues include:

- Treatment of capital maintenance within PPP contracts for statutory accounting purposes – currently capital costs are capitalised within fixed assets rather than being expensed to the profit and loss account with an adjustment being made to the economic life and residual value of the underlying asset which is being maintained. Whilst the values are not significant in the early years of the contract, the maintenance costs increase annually as to underlying asset becomes older and consequently management need to review the treatment as soon as possible.
- Inaccuracies in transferring items from assets in the course of construction to the relevant fixed asset category;
- Negative assets included in the assets in the course of construction category;
- Incorrect asset lives being used for intangible assets; and
- Incorrect prices being used in respect of adopted assets.

4.5.2 We have made a number of detailed recommendations to management in respect of the issues outlined above.

**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 two reorganisation costs in their commentary. The Business Improvement Programme ('BIP') which 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 Both 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 (£3,014k) 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 £12,342k = £617k) has been used as materiality for Part C. We draw your attention to the fact that the actuarial valuation provided by the company's actuary is an IAS19 valuation as required by International Financial Reporting Standards as adopted by the EU. There are no significant differences between an IAS19 valuation and a FRS17 valuation under UK GAAP. Accordingly no amendments have been made to the references to FRS17 set out in this section.

**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 4.3.2). 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 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 to reflect the fact that only the element of the pension asset relating to the Northgate service should have been accounted for rather than the entire service of these employees. We do note however that the number of employees, and associated pension assets, are very small.

**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 The finance income in respect of the pension asset (£676k) has not been included within interest in table 18d as management had posted this in error to operating expenses. We have brought this to the attention of management in our year end reporting.

5.3.2 Tables 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 5.2.1 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 26.9% for the year ended 31 March 2011. 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 20 of the statutory accounts indicates that management anticipate contributions of approximately £11.8m in 2011/2012 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 £3.2m 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 The valuation provided by the company’s actuary is an IAS19 valuation as the statutory accounts are prepared under International Financial Reporting Standards as



adopted by the EU and as such an FRS17 valuation has not been prepared. We note however that there would be no material difference between the IAS19 and the FRS17 valuation. The key assumptions in 2011 and 2010 are set out below:

| Assumption  | 2011  | 2010  |
|---|-------|-------|
| Discount rate   | 5.50% | 5.75% |
| Inflation   | 3.50% | 3.75% |
| Rate of increase in salaries                                  | 4.50% | 4.75% |
| Rate of increase in pensions in payment and deferred pensions | 3.50% | 3.75% |

Changes in mortality assumptions have led to a relatively small increase in expected longevity of members and thereby an increase in the pension liabilities. The mortality rates are based on the SAPS03 table with long cohort mortality improvement and a minimum improvement per year of 1.0% for both males and females.

- 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 The employer contribution rate remained constant during the year at 26.9%. There is currently a pension asset (surplus) of £4.6m after deferred tax (£6.2m before deferred tax). We agreed the 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. £345k) 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 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 The majority of adjustments are non-recurring in nature and relate to movements in provisions and accrued income due to changes in the billing cycle in the current year. Recurring adjustments relate to variances between accrued income and amounts actually billed, in addition to general movements in the test meter accrual.
  - 6.1.3 We note that the prior year comparatives in Table 23 have been restated by the company to include an element of measured water, sewerage and trade effluent within the large user category that is separately disclosed in the table. We note that the figures in the regulatory accounts do not include the information in the same format and consequently the numbers, whilst reconciling to the accounts, do not tie directly in. We have not carried out any work in respect of the restatement of the comparative figures.
- 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 PC10 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 PC10, after adjusting for a change in revenue mix given the deferral of domestic charges and phasing of subsidy income.
  - 6.2.2 The monitoring process introduced in prior years has been further refined in the current year whereby the use of the Dynamic Consumption Report (“DCR”) in the prior year and quarterly re-forecasting has been further developed. In the current year the company have used the ‘actuals report’ instead of the DCR and the purpose of this

is to provide management with more detailed information in respect of consumption, broken down by customer categories and types, thus enabling the company to more accurately identify trends and fluctuations which in turn allows them to forecast future consumption with more accuracy. The Finance and Customer Services teams meet on a monthly basis to discuss emerging variances with the 'actuals report' 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. Where subsequent meter readings are at variance with the expected amounts taken from the accrued income report, this is taken into account in estimated forecasted revenue.

- 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 PC10. 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 2010/11 was £10.3m (3%) below budget (including non-appointed revenue). The majority of this movement may be attributed to the measured water and sewerage (excluding subsidy income) category where movements in provisions account for the majority of the reduction in actual income. Also, customer numbers and average consumption have both fallen against budget. 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 10/11 has been agreed to the Oracle nominal ledger and reconciled to underlying customer billing reports. We note that a number of specific provisions have been made in respect of accrued income including: (1) £2.4m in respect of Dynamic Consumption Reports ("DCR")/System adjustments – these relates to potential adjustments to reflect the fact that accrued income is based on historic trends which are unlikely to accurately reflect current volumes (i.e. meters currently being read are showing lower volumes than the DCR suggests); (2) £1.8m in respect of pipe size adjustments resulting from errors identified in the year. These errors have been communicated to customers and has been subject to press coverage in the year; (3) £0.6m in respect of provisions relating to the freeze/thaw incident whereby accrued income is overstated due to leakages etc...; and (4) £0.4m in respect of specific overbilling to two individual customers in the year. We have also reviewed the provisioning levels against accrued income and note that the policy is consistent with that used in the prior year.

- 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 implemented reconciliation procedures during the year, which now facilitate the comparison of amounts billed to those previously accrued for both monthly and six monthly customers.

Work undertaken during the current year as part of this reconciliation identified an over-accrual of circa £1.1m in respect of accrued income at 31 March 2010. This has led to NI Water increasing their provision against accrued income at the current year end.

Management have noted in their commentary that an in-depth report comparing income billed in April 2010 to the accrual at 31 March 2010 is unavailable, however the report that they have developed has identified an overstatement of accrued income in the prior year.

- 6.5.2 We recommend that management continue to develop the reconciliation 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. +/- 167k
- Write offs – movement of +/- 0.1% of turnover i.e. +/- £345k
- Revenue outstanding – movement of +/- 1% of turnover i.e. +/- £3.45m
- We have assumed a materiality threshold of 0.1% of turnover for customer services operating expenditure i.e. £345k

### 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 10/11 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 £3.8m greater than the figure included in the AIR due to an adjustment in respect of potentially irrecoverable debt in the amount of £6.6m, test meters which have been recognised in the Oracle nominal ledger but are not yet billed on Rapid Xtra (£0.2m), and additional revenue which has been recognised in the Oracle nominal ledger but not yet billed on Rapid Xtra (£0.1m). The test meter adjustment of £0.2m is stated after a provision of £750k (2009/10: £750k). These reductions from the nominal ledger figure are offset to an extent by the reclassification of credit balances (£3.1m).
- 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 £1,604k populated in lines 57a and 58a has been reconciled to the Oracle nominal ledger.
- 7.1.7 The customer services operating expenditure of £6,667k 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.

### **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 in the current year; 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 decreased by £2.06m (16%) on prior year due to a reduction of £8m in measured income, continued improvements in cash collection, increased bad debt provision of £1.1m and Legacy Debt write offs of £0.6m processed in the 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 The nominal ledger figure is £3.8m greater than the figure included in the AIR due to an adjustment in respect of potentially irrecoverable debt in the amount of £6.6m, test meters which have been recognised in the Oracle nominal ledger but are not yet billed on Rapid Xtra (£0.2m), and additional revenue which has been recognised in the Oracle nominal ledger but not yet billed on Rapid Xtra (£0.1m). The test meter adjustment of £0.2m is stated after a provision of £750k (2009/10: £750k). These reductions from the nominal ledger figure are offset to an extent by the reclassification of credit balances (£3.1m).
- 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 10/11 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 decreased by 64% on prior year due to the release of a commercial claim provision, reduction in consultancy costs and reallocation of salary costs to the Business Improvement Team. This explanation is included in the commentary to tables 21 and 22 and is consistent with our understanding of debt collection and movements observed during statutory fieldwork.
- 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 line 60. NIAUR has confirmed in writing that Line 60a is not required.
- 7.14 **Check that reported numbers for household costs for outstanding revenue collection operating expenditure in line 60 and 60a 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 10/11 therefore no outstanding domestic revenue at the year end and no balance reported in line 60. NIAUR has confirmed in writing that Line 60a is not required.
- 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 10/11 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 except for 2 amendments: (1) an increased provision for test meter debt in the amount of £429k; and (2) increased provision in relation to outstanding debts from customers operating in sectors that are most at risk in the current economic climate in the amount of £1,083k. 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 decreased in the year due to the influences outlined in 7.7.1 above.

| Table | Line |   | AIR<br>2011<br>£m | AIR<br>2010<br>£m | AIR<br>2009<br>£m | Variance from<br>2010 AIR to<br>2011 AIR<br>£m |
|-------|------|---|-------------------|-------------------|-------------------|--|
| 21    | 18   | Doubtful debts  | 1.955             | 0.648             | 2.131             | 1.307  |
| 22    | 17   | Doubtful debts  | 0.907             | 0.463*            | 1.094             | 0.444  |
| 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)   | 10.796            | 12.721            | 7.875             | (1.925)  |
| 6a    | 41   | Total revenue outstanding > 48 months (measured non-households)   | -                 | -                 | -                 | -  |
| 6a    | 43   | Total revenue outstanding < 48 months (unmeasured non-households) | 0.163             | 0.302             | 0.584             | (0.139)  |
| 6a    | 55   | Total revenue outstanding > 48 months (unmeasured non-households) | -                 | -                 | -                 | -  |

\* From restated 2010 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 (£1.111m) is the result of £353k bad debts written off and a £758k increase in bad debt provision. Of the £2.862m current year total bad debt charge, £1.375m can be directly allocated to Table 21 (Water) and £309k can be directly allocated to Table 22 (Sewerage). The remaining £1.178m has been allocated to tables 21 (£580k) and 22 (£598k) on the basis of the proportion of income received. Overall this results in a 68.3% allocation to Table 21 and 31.7% allocation to Table 22. The current year bad debt charge relates to £1,188k bad debts written off and a £1,674k increase in provision. The increase on the prior year is largely due to the increased level of provisioning in respect of test meters and industry specific customers as referred to in 7.19.1 above.
- 7.20.3 We note that there are limitations when reviewing the consistency over time of 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 decreased by £1.925m from the prior year due to a reduction in measured income, increased bad debt provision of £1.1m and Legacy Debt write offs of £0.6m processed in the year.
- 7.20.5 Line 43 of table 6a representing unmeasured non household debt less than 48 months old has decreased by £0.139m 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 is consistent with the prior year policy except for two further amendments detailed at 7.19.1.



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

### **Both 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 noted that management recognised impairment losses/accelerated depreciation in respect of sites that were to be decommissioned in future years to ensure the asset was stated at its recoverable value at the date of decommissioning. As a result impairment losses/accelerated depreciation totalled £10.8m (historic cost), £21.6m (current cost), was recognised in both the statutory and regulatory financial statements.
- 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 2011, there are fixed assets with total gross current cost of £1,725k (2010: £6,931k) 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 number of assets were decommissioned in 2010/2011 following an extensive management review. Assets written off in the year but not fully depreciated with a Gross Current Replacement Cost (GCRC) of £533k and accumulated depreciation of £112k 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.
- 9.1.4 We note that an adjustment was made to the statutory accounts, the regulatory accounts and the associated AIR 11 Tables in respect of assets identified during the year as not being in existence at the date of the transition to Northern Ireland Water Limited as a government owned company. The impact of this adjustment on the current cost accounts was to increase Sewerage assets by approximately £12.7m and to reduce Water assets by an equivalent amount. This will impact on current cost depreciation in future years.
- 9.1.5 We note that there was a difference of approximately £900k in the gross cost of fixed assets and the accumulated depreciation when reconciling the opening balances to the regulatory accounts. Whilst this has no impact on the net book value of fixed assets we recommend that management investigate and reconciled this difference at the earliest opportunity.



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 the final determination arriving from PC10. Management note in their commentary to table 33 that the Regulator determined that the IRC and IRE will be the same for the three year period of PC10. The PC10 determination is based on an operational assessment of activity needed to maintain the serviceability of the underground infrastructure using the definitions within RAG 1.04.
- 9.3.2    We 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.
- 9.3.3    We also noted in 4.5.1 an issue in respect of the treatment of capital maintenance within PPP contracts for statutory accounting purposes which is currently capitalised within fixed assets rather than being expensed to the profit and loss account with an adjustment being made to the economic life and residual value of the underlying asset which is being maintained. We note that this may have impact on IRE and IRC going forward.
- 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    The statutory accounts are prepared under International Financial Reporting Standards as adopted by the EU. These standards prohibit the use of renewals accounting and accordingly there is no value for IRC in the 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 £738k (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.
  - 11.3.2 We note 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 on the date of the issue of the loan note. 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.
  - 11.5.2 The only borrowings that mature in less than one year relate to the current year element of the PPP creditor and amount to £3.6m.



## 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 all PPP contracts (Alpha, Omega and Kinnegar) are treated as “on” 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 a difference between the statutory accounts and the regulatory accounts in terms of the “on/off” balance sheet classification of the PPP contracts. The statutory accounts are prepared under International Financial Reporting Standards as adopted by the EU whereas the regulatory accounts are prepared under the regulatory guidelines and UK GAAP. As such the regulatory accounts treat the Kinnegar and Omega contracts as “off” balance sheet.
  - 12.1.3 The amounts recognised in the current year in respect of PPP contracts are in accordance with UK 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]
- 12.6      **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]
- 12.9      **Ensure that amounts recorded in lines 10 and 16 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 UK 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]

