

---

northern ireland  
**water**



---

**A Bid by Northern Ireland Water  
within the terms of the  
Memorandum of Understanding:**

**Relevant Items**

13<sup>th</sup> February 2012

Contents

1 The Memorandum of Understanding and Consequent Written Agreement.....3

2 Explanation of relevant items .....4

3 The Case for an Alteration of Funding.....4

4 Addressing the Criteria for Assessment of the Submission.....5

Annex A – NI Water relevant item bid – additional detail .....7

# 1 The Memorandum of Understanding and Consequent Written Agreement

- 1.1 The Memorandum of Understanding (MoU) documents the agreement between the Northern Ireland Authority for Utility Regulation (the Utility Regulator) and the Department for Regional Development (DRD) with regard to their functions set out in the Water and Sewerage Services Order (Northern Ireland) 2006 (the Order) for regulating water and sewerage service undertakers.
- 1.2 Through the MoU, the Utility Regulator and DRD recognise the constraints that the public expenditure (PE) system imposes upon them in respect of NI Water's funding. Accordingly, the Utility Regulator and DRD agree that any request for alteration of funding which departs from the PC10 settlement by NI Water will be referred to them for joint review.
- 1.3 Section 4.1.4 of the MoU addresses Relevant Items. The Utility Regulator and DRD acknowledge that mitigation measures normally available under regulation (e.g. Reserves, IDOKs) cannot be used in the initial period. The Utility Regulator and DRD will therefore agree relevant items for which some provision, out with the determination, should be made.
- 1.4 Where DRD and the Utility Regulator have agreed additional provision for relevant items they will agree that such expenditure should be included in a bid for PE resources in addition to determined expenditure. However, any such additional provision must be held by the Department and only made available to NI Water in accordance with agreed written procedures for dealing with alterations to funding.
- 1.5 Section 9 of the Consequent Written Agreement, which accompanies the MoU, sets out the following criteria (which are not exclusive of other considerations that might be thought relevant) that the Utility Regulator and DRD will take account of when assessing a submission by NI Water.
  - i. Whether the proposed interim adjustments are (individually or collectively) above the materiality threshold (as defined in the MoU).
  - ii. The extent to which the factors leading to the request were within NI Water's power to control or mitigate;
  - iii. Costs associated with responding to emergencies or exceptional situations, or any pressures arising from requests for actions by NI Water which fall outside Ministerial Guidance may be regarded as outside NI Water's control;
  - iv. The extent to which adjustment to any of NI Water's activities, outputs or targets should be made (including contingency planning to address the Executive's inability to meet approved adjustments);
  - v. The extent to which a request for alteration addresses the global or net picture i.e., gives due attention to factors that might have reduced

the need for funding, as well as factors that might call for extra funding;

- vi. The extent to which adjustments to K should be applied by the Utility Regulator in future charging years; and
- vii. The existence of any additional provision for agreed relevant items outside the determination for PE funding.

## 2 Explanation of relevant items

- 2.1 The Draft NI Water 2012/13 Budget and Operating Plan will be submitted to the Board for approval on the 22nd February. It should be noted that, if the relevant items bids are met, NI Water will still anticipate a cash pressure of £1.4m (which, the company understands exceeds the DRD's PE (DEL) cover available to fund water and sewerage services).
- 2.2 In the meeting between DRD, the Utility Regulator & NI Water on 20th April 2011 it was agreed that any PE cover in excess of what is required to enable the company to spend in line with the PC10 Final Determination (PC10 FD) could be treated as a relevant item(s) and could be used as the basis for any bid by NI Water through the agreed MoU process.
- 2.3 This submission forms the basis of NI Water's request that relevant items funding held by DRD is released, enabling approval of the NI Water 2012/13 Budget and Operating Plan.

2.4 The relevant item bids are as follows:

- cover for clear line of sight (CLOs) Government accounting adjustments in relation to provisions (unrelated to the PC10 FD – purely as a consequence of NI Water's reclassification to NDPB in PE terms).
- cover for the PE implications of IFRS adjustments (unrelated to the PC10 FD – purely as a consequence of NI Water's reclassification to NDPB in PE terms);
- Carbon Reduction Costs (CRC); and
- non-domestic income reduction;

Annex A contains additional detail in respect of these relevant items.

## 3 The Case for an Alteration of Funding

If successful, this bid will allow the relevant item fund to be used to cover existing PE shortfalls in 2012-13 and additional pressures and will therefore enable the Minister to provide a full approval of the 2012-13 Budget and Operating Plan before the end of this financial year.

## 4 Addressing the Criteria for Assessment of the Submission

### 4.1 Addressing the Submission criteria

i. Are the proposed interim adjustments (individually or collectively) above the materiality threshold (as defined in the MoU - £0.5m)?

Yes.

ii. The extent to which the factors leading to the request were within NI Water's power to control or mitigate.

**CLoS accounting** – Government accounting requirement due to NDPB reclassification - not within NI Water's control.

**Income reduction** – Not within NI Water's control.

**IFRS adjustments** – Government accounting requirement due to NDPB reclassification - not within NI Water's control.

**CRC** - NI Water will be a mandatory participant of the scheme, the cost of this being entirely outside of NI Water's control.

iii. The Costs associated with responding to emergencies or exceptional situations, or any pressures arising from requests for actions by NI Water which fall outside Ministerial Guidance may be regarded as outside NI Water's control.

Not Applicable.

iv. The extent to which adjustment to any of NI Water's activities, outputs or targets should be made (including contingency planning to address the Executive's inability to meet approved adjustments).

Not Applicable – this bid is deemed to provide PE cover only with no impact on outputs or targets.

v. The extent to which a request for alteration addresses the global or net picture i.e., gives due attention to factors that might have reduced the need for funding,

as well as factors that might call for extra funding.

This bid is to provide PE cover to facilitate the Minister's approval of the NI Water 2012-13 Budget and Operating Plan as required in advance of the new financial year. In terms of costs, additional cover is being requested to allow accrual of CRC costs which are outside of the PC10 settlement. Although we do not anticipate cash payment of the 2012-13 charge in 2012-13, there is a policy requirement for the company to accrue and hold this amount. The 2011-12 accrual of £2m has been budgeted for payment in June 2012.

The IFRS adjustments and CLoS accounting adjustments are entirely as a result of NI Water's reclassification to NDPB status resulting in PE pressures not within the control of the company. They do not constitute spend over the PC10 FD and the PE cover is requested purely to satisfy the unavoidable consequences of NIW's unique status as a NDPB as well as a regulated utility.

At this stage it is known that non-domestic income in 2012/13 will be £7.2m less than that anticipated in the PC10 FD primarily as a result of the impact of the economic downturn on businesses.

In terms of the net position, the company naturally anticipates movement between costs which were taken into account in reaching the PC10 FD. Some costs are expected to fall – VER/VS for example, while others, like energy, are expected to rise. Through prudent management and planning NI Water has kept the impact neutral so that it can hit its PC10 efficiency target for 2012/13. Specifically, in terms of non-domestic income shortfall, NI Water would point out that it has absorbed approximately £11m (6%) inflationary pressures within operating costs, effectively adding to the PC10 efficiencies challenge.

vi. The extent to which adjustments to K should be applied by the Utility Regulator in future charging years.

Not Applicable – no request to re-open the PC10 FD.

vii. The existence of any additional provision for agreed relevant items outside the determination for public expenditure funding.

Not Applicable (although, as noted in paragraph 2.1 above, if the relevant items bids are met, NI Water will still anticipate a cash pressure of £1.4m (which, the company understands exceeds the DRD's PE (DEL) cover available to fund water and sewerage services).

## Annex A – NI Water relevant item bid – additional detail

This document provides additional detail on items classified as relevant items within the terms of the Memorandum of Understanding.

### Current Situation

Table 1 below shows that the draft NI Water 2012/13 Budget and Operating Plan requires £23.4m additional Cash DEL funding than the PC10 FD. Including relevant items which are included in the DRD funding column, there is still a cash pressure of £1.4m (which, the company understands exceeds the DRD's PE (DEL) cover available to fund water and sewerage services).

	PC10 FD 2012/13	Draft Budget 2012/13	Variance 2012/13	DRD Funding	Variance to DRD
Operating costs	191.3	191.3	-		
Non-domestic income	- 82.6	- 75.4	- 7.2		
CRC	-	2.0	- 2.0		
CLoS	-	13.3	- 13.3		
IFRS	-	1.0	- 1.0		
<b>Total Cash DEL</b>	<b>108.7</b>	<b>132.2</b>	- <b>23.5</b>	<b>130.8</b>	- <b>1.4</b>
Depreciation	71.5	52.3	19.2		
<b>Total DEL</b>	<b>180.2</b>	<b>184.5</b>	- <b>4.3</b>		

**Table 1 Summary of funding reconciliation**

The PC10 FD variance column forms the basis of the bids for relevant items which are included within this paper.