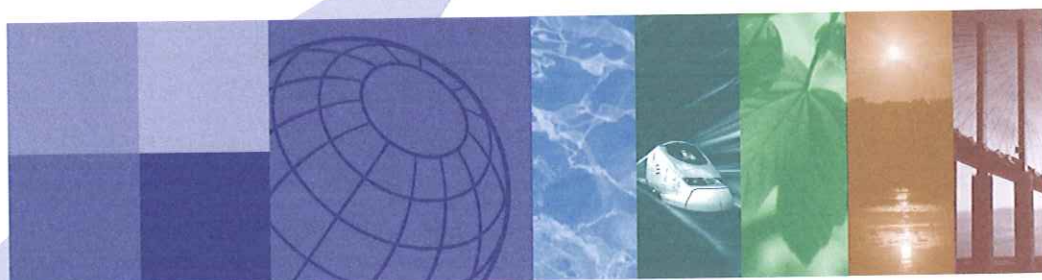


# **Northern Ireland Water Ltd**

Annual Information Return 2011

To the

Northern Ireland Authority for Utility Regulation



## **Public Domain Version**

**Part 5 of 10 containing:**

Regulatory Accounts - commentaries for tables 21, 22 and 25

**Reporter's Submission**

**By**

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**Halcrow Management Sciences Ltd**

***Halcrow***

**Table 21 and 22- Activity Costing Analysis - Water and Sewerage Service****Commentary by REPORTER****1. Background**

This table collects information on operating costs and maintenance costs. The information from this table is used to identify trends in operating costs and also to derive annual unit cost comparisons between companies.

**2. Key Findings**

- The company has applied the same method to the completion of these tables for AIR11 compared to AIR10.
- We consider that the company approach to the allocation of cost data is capable of reporting as required;
- For the report year the proportion of General and Support costs make up in the region of 55% of total direct costs. For equivalent companies in England and Wales, the split is approximately 28% of G&S costs compared to total direct costs. This variation may be due to: differences in allocations as compared to England and Wales; and/or NI Water's current business transformational activities; and/or inefficiencies
- The company has reported a number of atypical costs. These are discussed in more detail below. These costs have been included in general and support costs and customer services.
- The company has not disclosed details of donations to charitable trusts or fines and provisions made against Section 74 of the Roads and Street Works Act. The company advised that it has not incurred any such fines;
- The cost data relies on a combination of service activity code, expense code and responsibility code. In the majority of cases this should be sufficient to report data for the purposes of tables 21 and 22. However, it is possible that some costs will not neatly fit into the coding structure and the coding may require additional definition to ensure that NI Water is able to report more accurately at lower levels of granularity.

**3. Audit Scope**

During our audit we reviewed the company explanations for variations in costs. In addition we have commented on the procedures used for cost allocation.

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

## **4. Methodology (Non-PPP)**

### **4.1 Capitalisation**

Previously the Company had a threshold value for capital of £3,000. This represented a de-minimus figure. However, this has now reduced to only £1,000 while land has a zero threshold. The Company further confirms that even if an item is individually worth less than £1,000, because it is part of an operational configuration, it means that the asset should still be capitalised. The Company does not capitalise interest costs incurred as part of the acquisition of an asset.

### **4.2 Cost coding structure**

Data in tables 21 and 22 is based on information extracted from the General Ledger. All transactions within the General Ledger are coded to a cost centre with an associated Service Activity Code, Expense Type Code and Responsibility Code. Together, these allow for the reporting of information contained in table 21 and 22. The company advised that the activity code and expense type code together allow for the identification of the majority of expenditure for lines in tables 21 and 22. The responsibility code is used to split expenditure in cases where costs are 'general costs' such as customer services or scientific services.

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

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

In total, more than 1,050 service activity codes and expense codes are used in order to record the data in the general ledger system. Where the company is not able to allocate expenditure using the activity code, expense type code and responsibility codes, it uses a method based on direct costs to apportion costs.

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

#### **Service Activity Code**

The service activity code determines the type of work being carried out. It distinguishes between the water and sewerage service activities. Within the water service activities it distinguishes between distribution and water treatment and resources. Within the wastewater service activities it distinguishes between sewerage, sewage treatment and sludge treatment. Further division of the service activity code within these sub-service areas allows the company to identify costs of particular activities. Particular service activity codes are used to capture costs of management, administration and support functions. The service activity codes are shown below:

| NIW Service Activity | Service Activity description  | Table 21/22 Mapping                        |
|----------------------|---|--|
| 310                  | Pumping (Inc Highlift at WTW)   | Water - Distribution                       |
| 311                  | Service Resv Wat Tower Tanks  |  |
| 312                  | Service Resv cleaning   |  |
| 313                  | Distribution and Water Operations   |  |
| 320                  | Repair and Maintenance (Mains Repair)   |  |
| 321                  | Repair and Maintenance (Service Repair)   |  |
| 322                  | Repair and Maintenance (Hydrant & Valve Repairs)                                  |  |
| 323                  | R&M (NIFRS Hydrant & Valve Repairs)   |  |
| 324                  | Repair and Maintenance (Mains Cleansing)  |  |
| 326                  | Repair and Maintenance (Lead Replacement)   |  |
| 331                  | Repair and Maintenance of 'Street Furniture' (Water)                              |  |
| 340                  | Leakage - Monitoring  |  |
| 341                  | Leakage - Detection   |  |
| 342                  | Hydrant & Valve Repairs as identified by  |  |
| 343                  | Service Repairs as identified by active   |  |
| 344                  | Mains Repairs as identified by active Le  |  |
| 351                  | Consumer Meter Repair & Maintenance   |  |
| 360                  | Investigations  |  |
| 362                  | Customer Contacts excluding meter query   |  |
| 363                  | Regulatory Plumbing Inspection  |  |
| 380                  | 'In House' Investigations and Attendance  |  |
| 385                  | Health & Safety - Networks  |  |
| 391                  | Networks Function Activity -Query   |  |
| 399                  | Networks Stores   |  |
| 920                  | Connection (Water)  |  |
| 110                  | Impounding Reservoir  | Water - Resource & Treatment               |
| 111                  | Loughs  |  |
| 112                  | River Intakes   |  |
| 113                  | Boreholes,Springs & Wells   |  |
| 120                  | Repairs & Maint A/duct/Main   |  |
| 140                  | Recreation & Amenity  |  |
| 150                  | Water Treatment   |  |
| 151                  | Water Sludge Treatment  |  |
| 152                  | Water Sludge Disposal   |  |
| 185                  | Health & Safety - Supply  |  |
| 190                  | Supply Function Activity  |  |
| 191                  | Supply Function Activity - Query  |  |
| 822                  | Instrumental Control Activity M & E Water Supply                                  |  |
| 410                  | Repair & Maintenance of Sewers  | Sewerage - Sewerage                        |
| 411                  | Blockage  |  |
| 412                  | Desilting   |  |
| 413                  | Inspection of Sewers  |  |
| 414                  | Repair and Maintenance of 'Street Furniture' (Sewerage)                           |  |
| 415                  | Sewerage Tankering  |  |
| 430                  | Pumping (Foul & Combined)   |  |
| 431                  | Pumping (Surface Water)   |  |
| 460                  | 'In House' Investigations and Attendance  |  |
| 462                  | Rodent Control  |  |
| 940                  | Rechargeable (Sewerage)   |  |
| 950                  | Connection (Sewerage)   |  |
| 510                  | Sewage Treatment  | Sewerage - Sewage Treatment                |
| 591                  | Waste Water Function Activity - Query   |  |
| 620                  | Sludge Treatment - Tankering Between Works  | Sewerage - Sludge Treatment                |
| 621                  | Sludge Treatment  |  |
| 630                  | Sludge Disposal to Agricultural Land Transportation                               |  |
| 631                  | Instrumental Control Activity M & E WasteWater                                    |  |
| 632                  | Sludge Cake Transportation to Landfill  |  |
| 633                  | Sludge Cake Disposal to Landfill  |  |
| 635                  | Sludge Logger Maintenance (Contract)  |  |
| 636                  | Incinerator Sludge Treatment  |  |
| 637                  | Sludge Disposal Tankering from Strategic Collection Centres to Dewatering Centres |  |
| 638                  | Sludge Cake Disposal to Incinerator   |  |
| 639                  | Incinerator Ash Disposal to Landfill  |  |
| 640                  | Private Septic Tank Desludging  | Customer Services                          |
| 710                  | General   |  |
| 711                  | Customer Services (Meter Read & Customer Queries)                                 |  |
| 712                  | Disconnection / Reconnection  |  |
| 714                  | Consumer Meters Repair And Maintenance  |  |
| 790                  | Customer Services Function Activity   |  |
| 730                  | Water Analysis  | Scientific Services                        |
| 731                  | Sewerage General  |  |
| 732                  | Labs Water & Sewerage General   |  |
| 733                  | Sampling  |  |
| 734                  | Labs Sewage Sampling  |  |
| 003                  | Rates DRC - Water   | Rates                                      |
| 013                  | Rates DRC - Sewerage  |  |
| 910                  | Rechargeable Work   | Third Party Opex                           |
| 000                  | Default   | Overhead Pot 1 - General                   |
| 021                  | GAE   |  |
| 023                  | Invest to Save Revenue  |  |
| 810                  | Vehicle & Plant Maintenance   |  |
| 811                  | Vehicle & Plant Accident Repair   |  |
| 812                  | Garage Overheads  |  |
| 813                  | Roads Service   |  |
| 820                  | Telemetry   |  |
| 890                  | TMG Function Activity   |  |
| 050                  | Ops & Maint General (Water)   | Overhead Pot 2 - Water                     |
| 055                  | Ops & Maint General (Sewerage)  | Overhead Pot 2 - Sewerage                  |
| 585                  | Health & Safety - WW  |  |
| 590                  | Waste Water Function Activity   |  |
| 735                  | Trade Effluent  |  |
| 821                  | Radio & Monitoring Wastewater   |  |
| 390                  | Networks Function Activity  | Overhead Pot 3 - Networks Water & Sewerage |

## Expense Codes

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

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

### Responsibility Codes

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

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

The company confirmed that the personnel department are advised immediately after an individual receives revised responsibilities or job specification.

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

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

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

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

### 4.3 Cost to Serve Project

The cost to serve project has been partially implemented. It is still at a very early stage. Nevertheless staff timesheets for direct operations staff have been greatly simplified. Individual jobs are now automatically mapped to codes that allow for the reporting of expenditure in the AIR tables. However, this simplification may impact on the accuracy of some of the data reporting. For example, we note that a reduced amount of costs are going to sludge treatment compared to previous years. The Company considers that the full implementation of the cost to serve project may take a number of years. The Company considers the cost to serve project will be

implemented in three stages. These are 1) Provide cost data, 2) Understand cost data; 3) Drive costs down. The Company is still at the first stage of collection of data and refinements and improvements will be introduced over the coming months to improve the quality of data being reported.

#### 4.4 Allocations by Line (NI Water)

##### Employment Costs

The process relies on the completion of timesheets that use a mix of service activity and expense code for direct operations staff. For non-direct operations staff, expenditure is assigned on the basis of responsibility codes. For AIR11 the Company has included Vehicle Plant and Charges under employment costs. This amounts to £1.8 million in total across water and sewerage. Further, any redundancies are included in line 1. The Company has also included water resources and treatment; water distribution; sewerage; sewage treatment and sludge treatment and disposal VER costs directly into line 1.

##### Remaining Direct Costs

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

##### General and Support Expenditure

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

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

| Allocation of General and Support | Water |              | Sewerage |                  |                         |   |
|-----------------------------------|-------|--------------|----------|------------------|-------------------------|---|
|                                   |       |              |          |                  |                         |   |
| Description                       | R&T   | Distribution | Sewerage | Sewage Treatment | Sludge Treatment & Disp | Comments  |
| G&S Overhead Pot 1                | 26.1% | 26.0%        | 18.7%    | 18.7%            | 7.5%                    | Non ops general spend. Excludes CS, SS & Regulation |
| G&S Overhead Pot 2a - Water       | 48.2% | 51.8%        | 0.0%     | 0.0%             | 0.0%                    | Water related activities only                       |
| G&S Overhead Pot 2b - Sewerage    | 0.0%  | 0.0%         | 40.8%    | 42.8%            | 18.4%                   | Sewerage activities only                            |
| G&S Overhead Pot 3                | 26.1% | 26.0%        | 18.7%    | 18.7%            | 7.5%                    | Water and sewerage networks spend only              |

These costs are split as follows:

| Description  | Amount (£)        |
|--|-------------------|
| G&S Overhead Pot 1                                 | 42,915,535        |
| G&S Overhead Pot 2a – Water                        | 1,573,447         |
| G&S Overhead Pot 2b – Sewerage                     | 611,196           |
| G&S Overhead Pot 3                                 | 625,777           |
| <b>Total Unallocated General and Support Costs</b> | <b>45,725,954</b> |

The total value of general and support costs allocated at the time of our audit was in the region of £46 million. Of these, the largest portion of costs is allocated to General and Support Overhead pot 1, which accounts for more than 94% of the costs. General and Support overhead pot 2a accounts for about 3%, whilst the remainder is in General and Support costs pot 2b and pot 3.

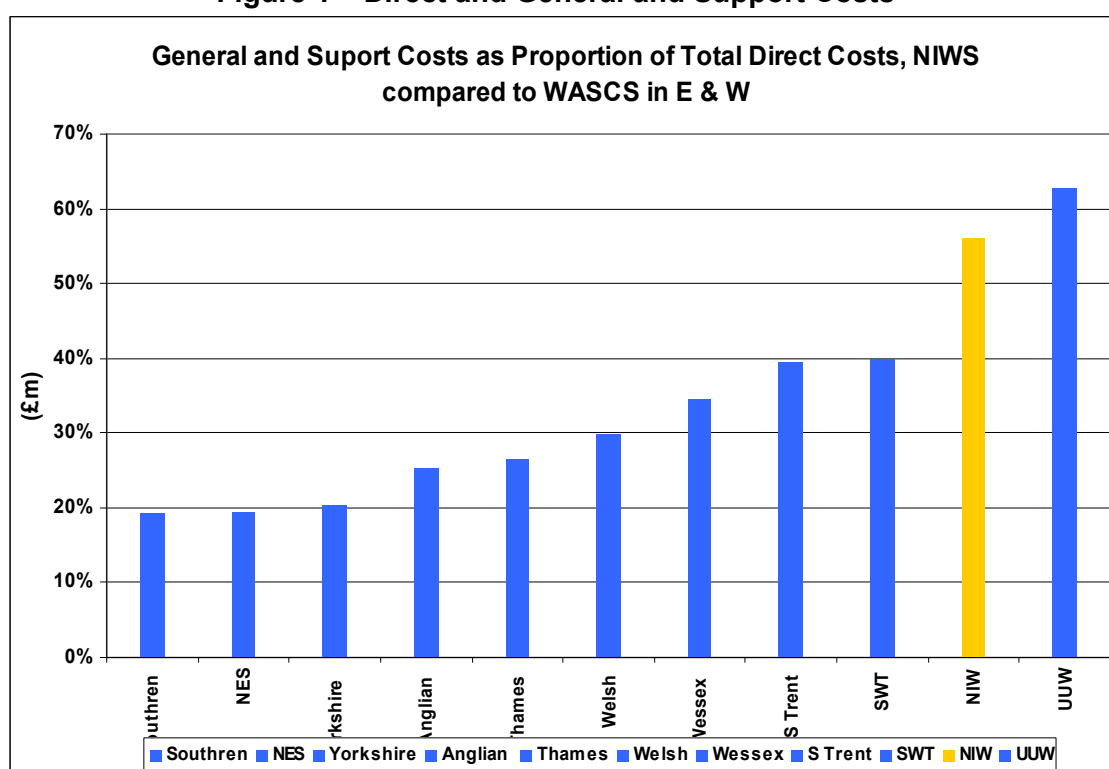


- Overhead pot 1 relates to non-specific General and Support costs. These have been split across the services on the basis of calculated total direct costs.
- Overhead Pot 2a and 2b relate to overheads for water and sewerage spend. These costs have been pro-rated on the basis of total direct costs within each of water and sewerage cost categories.
- Overhead Pot 3 relates specifically to networks functions activity. Again, the company has split this against each service activity on the basis of total direct costs. As these overheads relate specifically to network activities it may be more appropriate to split this expenditure against distribution and sewerage.

We note that Voluntary Early Retirement was allocated as a general and support cost last year. For AIR11 this has been included in the Employment costs reported.

Figure 1 below demonstrates the proportion of G&S expenditure compared to total direct costs for NI Water for 2010/11, for other WASCs in England and Wales and for the average of the WASCs in England and Wales. As the guidelines are the same it would be reasonable to expect the split of costs between NI Water and England and Wales to be broadly similar. However, as the chart below demonstrates, NI Water's proportion of general and support costs compared to total direct costs is almost double the average of England and Wales and is only surpassed by United Utilities.

**Figure 1 – Direct and General and Support Costs**





**Operating Expenditure**

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

|                           | Water  | Sewerage | Total  |
|---------------------------|--------|----------|--------|
| Customer Services         | 54.3%  | 45.7%    | 100.0% |
| Scientific Services       | 54.3%  | 45.7%    | 100.0% |
| Other Business Activities | 54.3%  | 45.7%    | 100.0% |
| Rates                     | 56.1%  | 43.9%    | 100.0% |
| Doubtful Debts            | 68.3%  | 31.7%    | 100.0% |
| Third Party expenses      | 100.0% | 0.0%     | 100.0% |

The 54.3% - 45.7% split above is based on total direct costs between water and sewerage.

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

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

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

**Customer Services**

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

Last year we challenged the company in relation to the possibility of service managers sharing responsibility across different areas such as customer services and debt recovery for example, or customer services and other business activities such as regulatory services. The company advised that *'There is a possibility, but the financial implications are deemed to be immaterial.'* We concur that such issues will be proportionately low, and there is likely to be some netting off, probably making this issue relatively insignificant.

**Scientific Services**

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

**Other business activities**

In order to report this data, the company uses responsibility codes.

**Rates**

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

**Doubtful Debts**

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

**Exceptional Items**

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

**Third Party Service - Opex**

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

**Total PPP Unitary Charges**

[ x ]

**Reactive and Planned Maintenance Infrastructure**

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

**Reactive and Planned Maintenance Non-Infrastructure**

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

**4.5 Allocation of costs to un-appointed activities**

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

**4.6 Atypical Costs****Reorganisation costs**

The company has reported a total of £4.6 million reorganisation costs. These are split between the business improvement programme (£2million) and Voluntary Severance (£2.6 million).

**Freeze Thaw Incident**

The Company spent an additional £5.1million on operating costs to deal with the Freeze Thaw incident. This was split between hired and contracted services (which accounted for half the additional spend) and employment and direct costs, which accounted for the remaining half.

**4.7 Fines and Donations****NRSA Fines**

The company has not made any comment in its commentary related to fines. However, the company advised that it has not had any such fines for the report year.

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

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

#### 4.8 Exceptional Items

The company has not reported any exceptional items for 2010/11. Atypical items are listed above.

#### 5. Table 21 Specific Lines

The Commentary below compares the AIR11 reported data with AIR10.

##### 5.1 A – Direct Costs

*Line 1* - The Company report a small increase in water treatment and water distribution. These are attributed to the inclusion of the VER costs and 616X vehicle and plant charges in line 1 for the report year.

*Line 2* - A small reduction in costs is attributed to reduced contract rates for power obtained from the electricity provider.

*Line 3* - The Company has not reported any costs in relation to Agencies.

*Line 4* - The overall reported increase is £2.8 million. This is largely attributed to the cost of the 'Freeze Thaw' incident although the Company has also included Leakage Repairs (which were previously a capex item) in this line.

*Line 5* - The Company has not reported any costs for associated companies for the report year.

*Line 6* - The Company has reported a small variation in materials and consumables.

*Line 7* - The Company has not reported any costs in this line.

*Line 8* - The Company has not reported any costs in this line.

*Line 9* - The Company report a slight reduction in costs. This is attributed to the movement of vehicle and plant charges from this line to line 1.

*Line 10* - This is the sum of lines 1 to 9.

*Line 11* - The overall value compared to AIR10 has not changed significantly. However, as many of these costs are apportioned across service areas based on direct costs, and as direct costs have changed between the two years, the allocation of General and Support costs between business units has changed for AIR11.

*Line 12* - This is a calculated line. This is the sum of direct costs and general and support expenditure reported above.

## 5.2 B - Operating Expenditure

*Line 13* - The Company reports an overall reduction of £4.6 million. The Company advise that this is due to reduced project work and costs for a claim included in AIR10, which are not present in AIR11. The percentage split between water and sewerage services has changed as noted above as this is pro-rated to reflect the split of direct costs between the services.

*Line 14* - Only a marginal change has occurred in these costs between the two years.

*Line 15* - Only a marginal change has occurred in these costs between the two years.

*Line 16* - This is a calculated line. It is the total of Lines 13, 14 and 15.

*Line 17* - Only a marginal change has occurred in these costs between the two years.

*Line 18* - This relates to doubtful debts payments. The company advised that doubtful debts have increased by £1.4m due partly to the write off of pre-2007 debt and partly due to a revised provision.

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

*Line 20* - This is a calculated line.

*Line 21* - Only a marginal change has occurred in these costs between the two years.

*Line 21a* - The Company has reported [ x ] increase.

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

*Line 22a* - Only a marginal change has occurred in these costs between the two years.

## 5.3 C - Reactive & Planned Maintenance

*Line 23* - This line relates to infrastructure maintenance. The Company has advised that this figure has increase by £2m due to the inclusion of the cost of leakage repairs, which was previously reported as capital.

*Line 24* - This line relates to non-infrastructure maintenance. The Company advised that the reduction in the report year is due to cheaper electricity that has been procured in 2010/11.

## 6. Table 22 Specific Lines

### 6.1 A – Direct Costs

The Commentary below compares the AIR11 reported data with AIR10.

*Line 1* - The Company report an increase of £0.4m. This is attributed to the inclusion of the VER costs and 616X vehicle and plant charges in line 1 for the current year.

*Line 2* - The Company has reported a reduction in sewerage power costs of £2 million. This is attributed to the cheaper electricity from the new contract that began on the 30 September 2010.

*Line 3* - The Company has not reported any costs in relation to Agencies.

*Line 4* - There has been a £9m reduction. This is split £8m Sludge Treatment and Disposal and £1 million in Sewage treatment. The reduction in Sludge Treatment is due to the incinerator now being operated by the PPP contracts. Similarly the reduction in Sewage treatment is due to new PPP contracts now undertaking this service for NI Water.

*Line 5* - The Company has not reported any costs for associated companies.

*Line 6* - Materials and consumables have reduced by circa £1.1m with £1.0m in sludge treatment and disposal. This is attributed to the incinerator now being operated by the PPP contractor.

*Line 7* - The Company has not reported any costs in this line.

*Line 8* - These costs have reduced by £1.3m. The Company advised that this is due to Vehicle and Plant charges that were previously reported under line 8 now being reported under line 1.

*Line 9* - This is a calculated line.

*Line 10* - The overall value compared to AIR10 has not changed significantly. However, as many of these costs are apportioned across service areas based on direct costs, and as direct costs have changed between the two years, the allocation of General and Support costs between business units has changed for AIR11.

*Line 11* - This is a calculated line.

## 6.2 B - Operating Expenditure

*Line 12* - The Company advised that customer services costs have decreased by more than £7m compared to AIR10. [  
x

] As this is split on the basis of direct costs some of the fluctuation is also due to changes in the split of direct costs between water and sewerage services.

*Line 13* - Line 13 relates to scientific services costs. There has been a marginal reduction. Costs are split between water and sewerage on an equivalent basis to that described under line 12 above for water.

*Line 14* - The Company has advised that the following cost categories exist for 'other business activities':

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

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

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

*Line 16* - This relates to local authority rates. We note an overall reduction of £2.3m. The Company advised that this was due to significant credit recovered in 2010/11 related to past years rates on Waste Water Treatment Works.

*Line 17* - There has been an increase in doubtful debts of £0.4m. The reason is partly due to write offs and partly due to the revised provision as discussed above.

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

*Line 19* - This is a calculated line.

*Line 20* - There has been no material change in this line between the two years.

*Line 20a* - The PPP unitary charged has increased to [ x ]. This is partly due to the incinerator now being transferred to the PPP contractor but also partly due to other PPP sites becoming fully operational during the year.

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

*Line 21a* - There has been an increase in the region of [ x ]. This represents a full year's payment to the operator for sludge disposal services.

### **6.3 C - Reactive & Planned Maintenance**

*Line 22* - This line relates to infrastructure maintenance. There has been a marginal reduction of £0.3m in this line.

*Line 23* - This line relates to non-infrastructure maintenance. There has been a relatively small reduction of £0.6m in the report year.

## 7. Infrastructure Renewals Charge (IRC)

See Commentary for Table 33.

## 8. PPP Data Tables

### 8.1 General

For the report year, PPP facilities have continued to come on line. The Kinnegar contract has been providing services for a number of years. The sites at Alpha were all fully operational prior to the report year. The Omega contracts are all now fully operational as well. The Duncrue site became operational on the 31<sup>st</sup> March 2010. Omega consists of 2 sludge services sites and 5 sewerage sites as well as a sludge remediation site.

### 8.2 Methodology (PPP)

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

- The Kinnegar contract was designed in the 1990s. It was designed prior to any consideration for a Government company. As a result, no clause exists for the provision of regulatory information. In addition it should be noted that the contractor for Kinnegar is responsible for all operating expenditure, including electricity;
- For the Alpha contract there is an implicit requirement to provide this information. The company advise that any information requirements are discussed in relation to whether or not it falls within the scope of the contract, but that the contractor is very supportive and co-operates with almost all of the regulatory information requests;
- For the Omega contract the obligation for regulatory reporting data is explicit. The company advised that the contractor has been supportive in any requests for information that have been made.

### 8.3 Variation from Previous Years

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

#### 8.3.1 Table 21 – Specific Lines

*Line 2* - The power costs here relate to water resources and treatment for the [ x ]. [ x ] provides potable water. Costs have reduced by circa 3% and the reason for the reduction is attributed to the revised contractual rates for electricity purchase.



The reported costs reflect a full year of the power attributed to [ x ] in this reporting period. As the costs are coded individually within the company system for large site power costs, data has been extracted from the general ledger Oracle system.

*Line 9* - No costs have been incurred in the report year.

*Line 11* - There has been an overall reduction in general and support costs, attributed to the reduced need for consultancy services now that the contracts are operational.

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

*Line 17* - Rates costs have reduced slightly to £2.7m from the £2.835m reported in AIR10. The Company advised that this is due to an accrual release from 2009/10.

*Line 21a* –  
[ x ]

*Line 22a* –  
[ x ]

### 8.3.2 Table 22 – Specific Lines

*Line 2* - The Company has reported a £2.4m increase for power costs. This is due to new sites coming on line during the report year.

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

*Line 10* - There has been an overall reduction in general and support costs, attributed to the reduced need for consultancy services now that the contracts are operational. The analysis is based on an assessment by the company of the number of staff employed within the PPP contract administration function. Not all staff are employed full time on PPP related activities. The company analysis relies on management judgement of where to allocate payroll costs of staff. We believe it is a simplification. However, in the absence of direct timesheet data we believe this an appropriate method of apportioning these

costs. In addition, any consulting costs incurred for this contract are included here.

*Line 13* - For the report year the company advised that it had provided a number of tests as contractually obliged under the Omega and Kinnegar contracts. This included tests related to suspended solids and determination of oxygen demand for processes. The overall variation is a cost reduction of 14% in nominal terms. We challenged the company in relation to information provided last year about reporting information for the Kinnegar contract only, whilst for Omega, this formed part of the charge.

In addition the company advised that costs have risen in 2010/11 as a result of the inclusion of Ballynacor costs.

*Line 16* - Rates costs of £4.244m have been paid for the current year. This is based on the actual rates bill which can be identified by site. Some apportionment was required to allocate the expenditure for the Duncrue site.

*Line 20a* –  
[ x ]

*Line 21a* –  
[ x ]

**Date:** 29 July 2011  
**Prepared By:** HMS

**Table 25 - Analysis of fixed assets by asset type****Commentary by REPORTER****1. Key Findings**

The Company advised that it has not made any AMP adjustments in this table for AIR11.

**Date:** 29 July 2011  
**Prepared By:** HMS