

Dŵr Cymru Cyfyngedig

2012 Accounting separation

Methodology statement

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Contents	Page
Methodology statement: activity costing analyses	1
Methodology statement: analyses of fixed assets	6
Capitalisation policy	9
Appendix I: material changes since 2010/11	11
Appendix II: plans for further improvement in 2012/13	12
Appendix III: use of sampling	13
Appendix IV: Ofwat's cost driver hierarchy for the allocation of general and support expenditure	14
Appendix V: due diligence	15

Methodology statement: activity costing analyses

Tables ST1, ST2, ST3

The purpose of this statement is to explain the systems, processes and allocation methods used to populate the accounting separation supplementary tables ST1, ST2 and ST3 included within Dŵr Cymru's Cyfyngedig's regulatory accounts for the year ended 31 March 2012. Material changes from the prior year have been summarised in Appendix I, and plans for further improvement can be found in Appendix II.

Costs are collected within cost centres set up within the company's accounting system, SAP; an alternate cost centre hierarchy has been designed and implemented to ensure that costs are collected in line with regulatory requirements.

Allocations have been prepared in accordance with the methods and driver hierarchies set out in the 2011 guidelines published by Ofwat. These allocations have been described below, along with any associated assumptions. Where alternative allocations have been considered appropriate, these are also detailed below. Sampling has not been used as a means of determining cost allocations, except as described in Appendix III.

Basis of cost extraction and allocation

Employment costs

Many employees within the organisation work on activities which are attributable directly to a single business unit, and their costs are therefore posted directly to that business unit within the relevant supplementary table.

Where employees serve multiple business units, a real-time work planning system (fully integrated with SAP) allocates costs to the relevant area based on final classification of the job and asset location. Operators and craftsmen have hand-held devices which they use to input hours worked – this minimises the level of costs which require allocation using management judgement.

Where management judgement is required, departmental managers assess the proportion of each employee's time spent on services at the beginning of each year; this information is input to SAP via monthly allocation cycles. Managers' judgement is reassessed at the end of each year following a review of actual activity and adjustments are made to the original assumptions if necessary.

Power

Electronic bills are received from energy providers and costs are posted to the supply point in Dŵr Cymru's power management system (ARIES) which interfaces with SAP. ARIES also records consumption and, based on historical consumption, generates accruals. Power costs have been allocated directly to business units where possible.

Where costs relate to a site which covers multiple business activities, sub-meter data is used where available. Management judgement is used to allocate the remaining power, with assistance from the power managers. Income received from energy generation is recorded as a credit to power costs.

Agency costs

Agency costs relate to the costs of subcontracting sewerage services to local authorities and are attributable directly to sewage collection.

Hired and contracted services

Hired and contracted services costs are allocated directly to business units.

Mechanical, electrical maintenance and instrumentation costs are allocated directly to process via an integrated work management system.

Materials and consumables

Materials and consumables include chemical costs and are allocated directly to business units.

Service charges

Service charges relating to discharge consents are allocated directly to relevant business units. Abstraction charges are included within water resources.

Other direct costs

Other direct costs comprise rent payable in respect of two sites (allocated directly to water treatment) and insurance charges (allocated to business units in proportion to direct costs).

General and support expenditure

General and support costs are allocated directly to business units where possible. Where this has not been possible cost drivers have been used to apportion departmental costs in line with Ofwat's hierarchy of cost drivers (Appendix IV).

Scientific services

Scientific services costs have been allocated across the business units based on the number of samples taken within each business activity and include an allocation of general and support costs.

Other business activities

Other business activities include the costs of the regulation department, Ofwat fees and Water UK fees. These costs have been apportioned equally over the ten business units in line with Ofwat's guidance.

Local Authority rates

Cumulo (water-only) rates have been allocated in proportion to the gross MEA value of assets assigned to the business units as reported in the fixed asset supplementary tables. Non-domestic rates relating to sewerage sites have all been allocated to sewage treatment. Non-domestic rates relating to offices have either been allocated directly to business units or, if not possible, allocated on the basis of employment costs.

Third party services

Third party services include costs relating to the supply of non-potable water, standpipes, ships water, bulk supply and reservoir agreements.

Retail service (ST2)

Throughout the year to 31 March 2012, most of the activities identified within the retail service were outsourced to Veolia; these costs have been allocated between household and non-household based on billing volumes.

Doubtful debts

Bad debt charges have been split between household and non-household based on the equivalent split of revenues.

Council commissions

Council commissions have been allocated across billing and debt management using management judgement.

Network inspectors

Network inspector costs have been allocated using job types.

Services to developers

The costs of services to developers have been allocated to non-household.

Customer services

Customer services costs have been allocated to other direct costs – household, while business customer services costs have been allocated to non-household.

Call centre costs

Call centre costs have been allocated to household and non-household based on call types.

General and support costs

General and support costs have been allocated to direct costs in proportion to direct costs, and apportioned to household and non-household in proportion to direct employment costs.

Methodology statement: analyses of fixed assets

Tables ST4, ST5, ST6, ST7

The purpose of this statement is to explain the systems, processes and allocation methods used to populate the accounting separation supplementary tables ST4, ST5, ST6 and ST7 included within Dŵr Cymru's Cyfyngedig's regulatory accounts for the year ended 31 March 2012. Material changes from the prior year have been summarised in Appendix I, and plans for further improvement can be found in Appendix II.

Costs are initially collected within the fixed asset module of the company's accounting system, SAP. In order to arrive at a current cost position, the asset valuation carried out for PR09 (MEAV) has been used to represent the value of all assets held as at 31 March 2008 – this valuation, along with subsequent movements, is then inflated to outturn prices using the RPI indices published by Ofwat.

Allocations have been prepared in accordance with the methods set out in the 2011 guidelines published by Ofwat as described below.

Basis of cost extraction and allocation – ST4, ST5, ST6

Lines 1 and 8: opening balances

These have been agreed to the prior year's closing balances.

Lines 2 and 9: AMP adjustment

These lines were used as at 31 March 2010 to record the adjustment needed to bring opening balances in line with those held within the MEA valuation prepared for PR09. They will not be used again until either the occurrence of an IDoK or the end of the current AMP period in 2015.

Lines 4 and 13: RPI adjustment

These lines inflate the opening balances to outturn prices using closing RPI indices as published by Ofwat.

Line 5: disposals (cost)

The disposals reported in the year relate to maintenance expenditure included within additions (line 6) which, it is judged, do not enhance the intrinsic replacement value of the asset derived for the MEAV.

Line 6: additions

Additions comprise the costs relating to above ground enhancement additions as well as above ground maintenance additions for the year. As discussed above, the latter are also shown as a disposal in Line 5 as it is deemed they do not increase the replacement value of the asset. Exceptions to this within the year are expenditure

classified as maintenance on our BIS schemes, advanced digestion programme costs for the schemes at Cardiff, Afan & Eign, strategic maintenance costs for the large named Water Treatment Works in AMP5 and the fit-out costs for a new property in Cardiff. All of these items are classified as maintenance for regulatory reporting, but are in fact enhancements to our asset base and as such increase the gross carrying value of assets.

These additions have been included in the relevant categories according to the guidelines published by Ofwat. Assets directly involved in the activities included within each of the business units are recorded in that business unit. In addition other assets used such as land, offices, depots, workshops, non-operational plant, machinery, vehicles and telemetry that are solely related to a specific business unit's activity are recorded directly in that business unit.

Where an asset is utilised in more than one business unit it has been apportioned using an appropriate cost driver, as discussed in Ofwat's "Detailed guidance on asset allocation" to reflect the proportion of usage by each business unit.

As part of the PR09 business plan reporting requirements, companies were required to group assets into asset types. In Ofwat's guidelines, the asset types as set out within the business plan tables have been mapped to the business units and general and support areas.

Where an asset inventory category is wholly attributed to one specific business unit, all assets contained within that asset type have been allocated to the relevant business unit.

Where an asset inventory category straddles business units, an appropriate allocation has been made, ensuring that capital expenditure and operating expenditure relating to the same activity are recorded in the same business unit.

Line 14: disposals (depreciation)

The CCD disposal figure reported in the year equals the cost disposal figure (line 5). The rationale for writing back this depreciation is that while the expenditure relating to above ground maintenance additions does not increase the replacement value of assets, it does improve their condition and therefore extends asset lives. The CCD charge on the assets contained in the MEAV is based on the assigned condition grade and deterioration at end March 2008 and therefore requires adjustment for subsequent maintenance expenditure.

Line 15: Charge for year (CCD)

The CCD charge for the year has been calculated by combining the CCD calculated for 2011/12 on all assets existing as at 31st March 2008 (taken from the MEAV), plus CCD on enhancement additions through to 31 March 2012.

The CCD of the asset base as at 31 March 2008 has been allocated across business units per the categorisation within the MEAV, in line with Ofwat's guidelines. CCD on

subsequent additions has been allocated based on the allocation of the additional investment to business units as set out in line 6 above.

All lines in the table with a confidence grade of A3 as we believe the process for determining CCD is based on sound historical records and the calculation steps are supported by detailed and verifiable analysis.

Basis of cost extraction and allocation – ST7

Meter stock values have been calculated in line with the methodology outlined above for supplementary tables ST4, ST5 and ST6, using the PR09 MEA valuation and an analysis of post-2008 additions.

Meter assets have been apportioned between household and non-household based on the number of metered households billed and the number of metered non-household customers billed.

Capitalisation policy

Accounting Policy

Costs charged to capital follow the company's accounting policy. This states that capital expenditure includes the following categories of cost:

Property, plant and equipment

Property, plant and equipment comprise:

- Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
- Other assets (including properties, overground operational structures and equipment, and fixtures and fittings).

Asset additions are recorded at cost together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs and, in respect of capital projects commenced after 1 April 2009, borrowing costs in accordance with IAS23.

The cost of property plant and equipment additions includes an accrual for incentive bonuses earned to date, relating to projects substantially completed at the year-end where the likelihood of making the incentive payment is considered probable. Amounts recoverable from contract partners relating to targets not being achieved are only recognised on completion of a project.

Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The waste water system is segmented into components representing geographical operating areas.

In accordance with RD 06/02, all leakage monitoring and reporting costs are treated as operating expenditure. The cost of maintaining leakage is also classified as such, unless it clearly falls in other areas i.e. replacement of capital items. The costs of detection and repairs in reducing leakage as initiatives to achieve the economic level of leakage are treated as capital expenditure.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is treated as additions, which are included at cost. Expenditure incurred in repairing and maintaining the operating capability of individual infrastructure components ('infrastructure renewals expenditure') is expensed in the year in which the expenditure is incurred.

Intangible assets

Intangible assets comprise principally computer software and systems developments. Additions are recorded at cost, which reflects the purchase price together with any expenditure directly attributable to bringing the asset into use, including directly-attributable internal costs. Costs incurred on development projects are recognised as intangible assets when the relevant recognition criteria are met.

Capitalisation of salaries

The cost of employees working directly on capital projects is calculated using an hourly recharge rate which is reviewed by management annually. Each set of rates is broken down by bands based on average salary and includes national insurance, superannuation, bonus payments, overtime, car allowances, PPE, mobile phone and training costs.

The planned maintenance system integrated in SAP records mechanical and electrical maintenance, labour, materials and bought in services costs at asset level. Craftsman time is recorded on handheld devices (“Toughbooks”) and job-types determine the classification of work as operating or capital expenditure.

Integrated work scheduling and cost systems record work scheduled on the system and allocate this to process operators and network teams via hand-held devices. Details of time spent and materials used are allocated to jobs via these hand-held devices. The final status of a job determines whether it is operating or capital expenditure (using the pre-defined settlement tables held within SAP).

Capitalisation of overheads

Welsh Water’s internal costs that support the capital programme are capitalised as overheads using an appropriate recovery rate. The recovery rate is based on a review of costs to identify those which demonstrate a clear link to the capital programme. The assumptions and recovery rate used are reviewed every six months by the finance team.

Appendix I: material changes since 2010/11

During the year to 31 March 2012 three company ledgers in SAP were integrated into one single ledger, following the in-sourcing of the operational contracts in the previous financial year. Alternative cost centre reports have been created which capture costs directly in line with regulatory requirements.

It was identified that a number of terminal pumping stations were incorrectly classified as terminal pumps in 2010/11; these items have now amended in SAP and consequently in the supplementary tables.

A revised accounting separation workbook was developed and used to prepare the tables, allowing costs to be allocated using more appropriate drivers as summarised in the main body of this document.

Appendix II: plans for further improvement in 2012/13

Dŵr Cymru is keen to continue to find ways of allocating costs directly to business units, and further work will be undertaken to reduce the amount of general and support costs allocated using a general costs driver.

As soon as revised reporting requirements are published, all relevant managers and financial personnel will be made aware of any changes.

Appendix III: use of sampling

Sampling has been used as a basis of populating the tables only where no other practical solution was identified. It has been used in the following two instances:

- 1) In order to ascertain the split of household and non-household operational work, a SAP report has been created which identifies the job-type associated with work carried out and whether it relates to a domestic or non-domestic property. Owing to the volume of transactions, a sample of these reports has been used to produce a proportional split between household and non-household costs.
- 2) A SAP report has also been created which extracts details of a sample of calls received and classifies them as water or sewerage and then further subdivides between household and non-household.

In both cases, the splits indicated by these samples have been applied to the total of the related costs.

Appendix IV: Ofwat's cost driver hierarchy for the allocation of general and support expenditure

General and support activity	Cost driver
Administrative services Planning liaison Financial services Management services Property management services Legal services Research and development Audit services Operational and technical support	<ol style="list-style-type: none"> 1. Analysis of staff time determined by hierarchy detailed above under employment costs 2. Number of full time equivalents (FTEs)
Human resources and personnel services	<ol style="list-style-type: none"> 1. Analysis of staff time determined by hierarchy detailed above under employment costs 2. Headcount of employees
IT and data processing	<ol style="list-style-type: none"> 1. Usage of mainframe by system type 2. Number of computers 3. Number of full time equivalents (FTEs)
Vehicles and plant	<ol style="list-style-type: none"> 1. Pro rata to direct allocation of vehicles and plant
Electrical and mechanical maintenance	<ol style="list-style-type: none"> 1. Pro rata to direct allocation of electrical and mechanical maintenance
Land and property maintenance	<ol style="list-style-type: none"> 1. Pro rata to direct allocation of land and property maintenance 2. Analysis of staff time determined by hierarchy detailed above under employment costs
Materials storage	<ol style="list-style-type: none"> 1. Pro rata to direct allocation of materials and consumables

Appendix V: due diligence

Dŵr Cymru has established appropriate processes and systems of control that provide the necessary assurance in respect of the information contained within the supplementary tables (previously part of the 'June Return tables'). These systems have recently had ISO9000:2008 accreditation reaffirmed following an audit undertaken by SGS Ltd in February 2012, and the company is now in its fifth year of holding this accreditation.

The company has documented key processes and internal controls and has assessed the quality of systems and processes used for generating regulatory information. These processes have been followed to produce this year's Performance Report. Although Dŵr Cymru is no longer required to produce a June Return the same processes has been followed as in previous years and table ownership has been retained.

Ownership and responsibility for each supplementary table have been clearly defined. Each individual is responsible for adhering to all appropriate guidance in the compilation of the data and associated commentary. This also involved formal 'sign-off' by the individual, verifying that the figures in each line had been obtained from a recognised data source and have been accurately compiled. In addition, confirmation was required that any material judgements or assumptions had been highlighted and documented, ensuring an accurate audit trail.

Allocation of overall responsibility for individual tables and associated commentaries was assigned to the appropriate Dŵr Cymru Leadership Team Member. Each was responsible for the review and 'sign-off' of his/her own tables and commentaries.

A rigorous process of internal due diligence meetings was undertaken by the Regulation Department between the 10 May and 13 June 2012 to challenge information, judgements and assumptions made and to ensure compliance with the relevant guidance.