

Accounting separation methodology 2017-18

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Author: Matthew Hersey and
Patrick Mallon

South East Water
Rocfort Road
Snodland
Kent
ME6 5AH
0333 000 2244

Table 4D/4F

1.1 Background and purpose

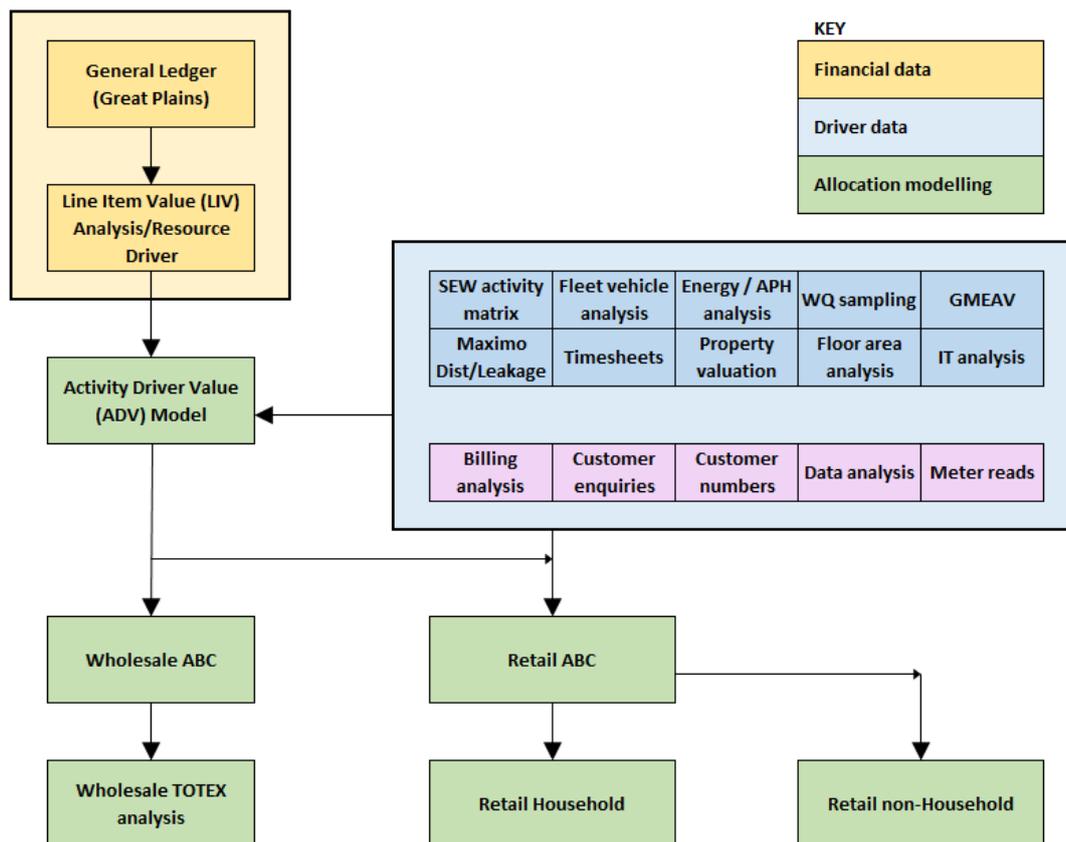
The purpose of this methodology statement is to illustrate the process and allocation procedures undertaken to complete the operating costs for table 4D (wholesale totex analysis) and 4F (retail).

1.2 Overall Table methodology

A combination of Excel models and ABC software is used to bind both cost and driver data to complete the operating expenditure separation tables.

Overview / Data and System Integration

An outline of system integration to produce operating expenditure accounting separation tables is given below.



As the above diagram outlines that inputs are either cost or driver related. All costs come from a single source, the general ledger (Great Plains), and are exactly replicated within the ABC model. The general ledger exports an operating expenditure extract. This is converted into a Line Item Value (LIV) analysis and contains the following information:

- Account cost code
- Account description
- Responsibility centre number
- Responsibility centre description
- Sum of period balance
- Stat adjustments
- Adjusted sum of period balance

The LIV analysis includes sixty-nine responsibility centres and this level of detail provides the platform of ensuring costs are allocated to the correct business unit. The LIV is analysed and for each combination of responsibility centre and account cost code a resource driver is assigned. Cost aggregated against these resource drivers are later allocated to business unit, and activity line, by use of activity driver value (ADV) allocations.

Given this level of detail significant combination of responsibility centre and account cost code can be specifically attributed to one business unit, and potentially to one activity line – hence the resource driver allocation has a value of 100% to one activity line. An example of this includes doubtful debt, which is a single account in the General Ledger, and a single line within the retail services table. Chemicals are another example of this allocation method, since these costs can be directly apportioned to the business unit water treatment. Additionally, the detailed level of the LIV can also mean direct coding of labour resource to business unit.

Where direct coding is not possible, the resource driver assigned can have multiple values to allocate cost across more than one business unit and/or activity line. In all cases the resource driver will always total 100% to ensure all cost is allocated. When determining resource driver values appropriate driver data is sought to ensure robust allocation.

Driver Methodology

SEW Activity Assessment – The purpose of this assessment is to understand every SEW resource purpose in the company. The company is at a size which currently makes this a feasible annual exercise and provides a robust analysis of activity across all business units and activity. The regulation and strategy team undertake an assessment with each responsibility centre manager and each member of staff is reviewed to understand their activity across the subject period. As outlined above a significant number of resources have a dedicated purpose to one business unit and are therefore directly assigned (e.g billing agent). Where resources are deemed to cross business units (or activities) then their time is appropriately allocated. Where this is the case we seek robust driver data (e.g. works management capture systems). Where direct driver data is not available then time is assessed by the responsibility centre manager. The assessment provides a powerful tool of SEW allocation and outputted data can either be used at a responsibility centre level, or aggregated to various levels of allocation (for example allocation of resource time spent at head office).

Maximo Distribution / Leakage – Maximo is our works management system used to record activity spent within our distribution network. For each activity there is a specific jobplan. We have mapped each jobplan to business unit, and we are therefore able to aggregate hours of resource time spent to each business unit which is used to allocate associated cost. We review the jobplan mapping assessment annually to ensure the allocation remains appropriate and includes any additions of any new jobplans created. Specifically Maximo distribution/leakage provides an assessment of resource time spent upon the treated water distribution network and conducting investigatory field visits to (retail) customers.

Energy kWh Analysis – Given the large proportion of cost attributed to energy the company invests a significant amount of time to energy management and optimisation. The benefit of this analysis provides a visibility of energy across the business units. We are constrained by the use of single point metering. The majority of key energy sites support the water resource function through to the high-lift pumps of treated water distribution. Via the cost-assessment approach the industry has made improvement with regard to average pumping head classification across the functions of accounting separation. In the absence of sub-metering, average pumping head provides the best proxy use of energy across the management functions, and we have therefore aligned our cost to this allocation measure. We believe this provides the best consistency for industry comparison.

Water Quality Sampling – to assist with the allocation of water quality activity we use sampling numbers undertaken across the business units. Given the size and geography of the SEW region we do not have a significant raw water network (i.e. the majority of abstraction and treatment is undertaken within a single site boundary). As such we assume no WQ samples are undertaken within a raw water network (i.e. samples are taken at either abstraction or within the treatment process).

Bulk Supplies - we receive both treated and untreated bulk supplies. We are aware of the RAG2 guidance to allocate bulk supply treatment across the relevant business functions. However we do not receive an allocated cost from either of our bulk suppliers (Affinity Water and Southern Water), and we are unable to establish a suitable allocation from their previous APRs. We are also concerned that using previous APRs would not be a suitable proxy of allocated cost since received volumes varies from scheme to scheme. We have therefore retained the previous allocation – i.e. untreated bulk supplies allocated to water resources; and treated bulk supplies allocated to water treatment. We are seeking collaboration from our bulk suppliers to improve their invoiced cost allocation for future periods.

IT Analysis – Analysis of key IT metrics are used to assist with the allocation of IT costs across business units and includes IT asset numbers and analysis of software licence costs.

GMEAV – The PR14 assessment of GMEAV has been used to allocate appropriate cost relating cumulo rates. We have updated the apportionment to take account of assets switching from water resources to network plus as per the revised regulatory accounting guidance in response to the pending water resources market. This has resulted in two surface reservoirs switching from water resources to raw water storage (network+).

Floor Area – Floor area has been used as an appropriate driver to allocate cost at office locations, for example local authority rates.

Fleet Vehicles – Numbers of direct vehicles is used to allocate associated cost (e.g. insurance).

Billing Analysis – Our retail systems are able to provide analysis of bills sent, payments received etc, across our customer base (including household; non-household, measured, and unmeasured). Billing analysis is used to allocate our retail costs.

Customer Enquiries – Volumes of contact enquiries are used to allocate appropriate retail costs. Customer data is available for both household and non-household, and measured and unmeasured. All customer enquiries are attributed a category code, which can be aggregated to network or non-network.

Meter Reads – Analysis of meter reads undertaken in the period ensure appropriate cost can be split across household, and non-household.

Customer Debt Analysis – Analysis of debt provision and debt outstanding greater than 30 days ensure we are able to robustly allocate associated costs.

Pension Deficit Recovery Payments

For PR14 we allocated the pension deficit recovery payments according to Ofwat’s guidance as set out in their information notice (IN13/17: Treatment of companies’ pension deficit repair costs at the 2014 price review, October 2013). For the period 2015-17 period we continued to allocate pension deficit recovery payments across the business units according to our own resource driver allocations prior to PR14. The driver for allocation is to pro-rata the deficit according to current contribution made at the responsibility centre level.

This year we have changed our approach to this cost allocation and believe it to be more appropriate to following the deficit payments as shown in IN13/17, rather than allocating based on current contribution. This is due to the fact that the deficit payment is more attributable to historic staff and therefore is more aligned to the percentages shown in IN13/17. This also ensures we remain consistent with the industry approach. The adoption of IN13/17 allocations will also carry through to our PR19 business plan, as recommended by the guidance.

IN13/17 provides allocation details for wholesale, retail household and non-household. We have used historical allocation to further disaggregate the wholesale price control. Therefore the final allocation of the pension deficit payment is as follows:

Water Resources	11.4%
Raw water distribution	0.4%
Water treatment	28.7%
Treated water distribution	36.9%
Retail household	17.0%
Retail non-household	3.0%

Methodology Changes

With the exception of the treatment of the pension deficit payment allocation the only methodology change is to align the allocation of energy spend to average pumping head allocation (reference table 4P). As outlined above definition and reporting of average pumping head has improved through the Ofwat cost-assessment approach, and we now consider this the best approach to ensure consistent reporting with the industry.

1.3 Wholesale

Methodology

The overall methodology is consistently applied to both wholesale and retail, however outlined below is an overview of wholesale methodology specific to the wholesale function, including water resources, raw water distribution, water treatment, and treated water distribution.

The below table provides a brief methodology view of Regulatory Account table 4D.

Operating expenditure		
4D.1	Power	Energy at supply point is analysed to assess their appropriate business unit. Where energy points cover multiple business units then average pumping head is used to allocate cost appropriately.
4D.2	Income treated as negative expenditure	SEW does not export any energy generation, and therefore no expenditure is recorded to this line.
4D.3	Service charges	The majority of service charges relate to EA abstraction licences and are therefore directly attributable to the water resource function. A smaller element of expenditure relates to discharge consents, and is directly attributable to the water treatment function.
4D.4	Bulk supply imports	Bulk supplies are a direct cost item at responsibility centre level and are therefore directly apportioned to either the water resources or water treatment function – since SEW receive both non-potable and potable supplies from neighbouring companies.
4D.5	Other operating expenditure	Included within this line are (direct) employment, hired and contracted, materials and consumables (e.g. chemicals), plus all general and support function costs. Pension deficits recovery payments are excluded from employment costs within this line and outlined in section C of table 4D.
4D.6	Local authority rates	Cumulo rates are apportioned according to our GMEAV allocations, whilst local authority rates are apportioned according to floor area.
4D.7	Total Operating Expenditure (excluding 3rd party services)	Calculated sum of above lines
4D.8	Third party services	Third party service costs are directly allocated from LIV analysis and relate largely to third party contractor damage and fire hydrant activity.
4D.9	Total Operating Expenditure	Calculated sum of lines 7 and 8

Atypical expenditure

The unprecedented freeze-thaw event that occurred in March 2018 also resulted in significant cost. Given the unique circumstances of this event we consider these costs to be atypical and have therefore recorded £2.136million in table 4J. The majority of this cost is associated to reactive maintenance cost, in addition to contractor and personnel costs which supported the incident. Additionally the incident also included £48k of atypical energy costs.

Significant Changes in Cost

Trigger levels for comment regarding significant change includes line fluctuation exceeding 2% of total operating expenditure (either wholesale or retail expenditure), and also individual line cost which has changed by more than 30% of the prior year figure.

Adjusting for our atypical cost relating to the freeze-thaw incident outlined above we have no expenditure items which trigger the above criteria.

We do note however that the allocation of energy has changed as we have aligned with the definition of average pumping head as set out in the recent cost assessment exercise. This has largely been focused on correcting the definition regarding the use of the high-lift pumps into network at treatment works.

1.4 Retail

Methodology

We continue to internally report customer services to a greater level of detail that outlined in table 4F, matching instead the guidance set out in RAG 2.07. The split below outlines the drivers used to allocate cost.

Activity Heading	Wholesale / Retail Allocation	Household / non-household allocation	HH measured / unmeasured allocation
Billing	Wholly in retail	Number of bills raised	Number of bills raised
Payment handling	Wholly in retail	Payments received	Payments received
Charitable trust donations	Wholly in retail	Wholly in household	Customer numbers
Vulnerable customers schemes	Wholly in retail	Wholly in household	Customer numbers
Non-network customer queries	Wholly in retail	Volume of queries	Volume of queries
Network customer queries	Wholly in retail	Volume of queries	Volume of queries
Investigatory visits	Time reporting (Maximo)	Volume of queries	Customer numbers
Other customer services	Wholly in retail	Customer numbers	Customer numbers
Debt management	Wholly in retail	Debt outstanding +30 days	Customer numbers
Doubtful debt	Wholly in retail	Direct attribution	Customer numbers
Meter reading	Wholly in retail	Number of meter reads	Number of meter reads
Services to developers	Direct attribution	Direct attribution	Wholly in non-household
Disconnections	Direct attribution	Direct attribution	Wholly in non-household
Demand-side water efficiency	Direct attribution	Customer numbers	Customer numbers
Customer side leaks	Direct attribution	Customer numbers	Customer numbers
Other direct costs	Wholly in retail	Customer numbers	Customer numbers
IT general & support	Direct attribution	Customer numbers	Customer numbers
Vehicle general & support	Direct attribution	Customer numbers	Customer numbers
Finance etc general & support	Direct attribution	Customer numbers	Customer numbers
Executive directors	Directorate activity assessment	Customer numbers	Customer numbers

Activity Heading	Wholesale / Retail Allocation	Household / non-household allocation	HH measured / unmeasured allocation
Facilities etc general & support	Direct attribution	Floor space Customer numbers	Floor space Customer numbers
Other general & support	Direct attribution	Customer numbers	Customer numbers
Other business activities	Direct attribution	Customer numbers	Customer numbers
Local authority rates	Central Gov't rates – GMEAV Local Auth' rates – Floor space	Customer numbers	Floor Area
Third party services	Wholly in wholesale	-	-

For demand-side efficiency initiatives and customer side leakage we have excluded wholesale funded activity (outlined in section B of table 4F) from section A of table 4F, i.e. only net retail expenditure is included. This is consistent with table 2C. Hence, wholesale funded initiatives remain part of the wholesale totex value.

We have looked to remain consistent with RAG2.07 with regard to selection of allocating drivers, however we have opted to differentiate from suggested guidance in two instances:

- *Debt management and doubtful debt* – with the metering programme in play we are currently experiencing a significant level of customer type switching. As such, debt formerly recorded against unmeasured properties could now be a measured. Subsequently we do not believe aged debt to be a suitable or consistent driver of cost given the current change and have therefore allocated cost on current customer type numbers.
- *Network customer queries/complaints and investigatory visits* – when apportioning between household and non-household we do so using customer volume data for the period, as prescribed in RAG guidance. Whilst we are able to extend the driver analysis allocation to household measured and unmeasured we have encountered anomalies in the data that lead to unmeasured customers having a lower cost to serve than measured customers. We believe this to be a result of our customer metering programme. We have therefore used customer type numbers to allocate cost, and is consistent with our approach that both measured and unmeasured customers receive the same level of service for network related issues.

Significant Changes in Cost (Household)

Trigger levels for comment regarding significant change includes line fluctuation exceeding 2% of total operating expenditure (either wholesale or retail expenditure), and also individual line cost which has changed by more than 30% of the prior year figure. The below outlines combined retail line components where either trigger has been exceeded, and have not been adjusted for inflation.

- *Debt Management*

	TOTAL 17/18	TOTAL 16/17	£variance	% of Opex	%line Increase
Debt management	£0.472m	£0.703m	- £0.946	- 1.5%	- 33%

Debt management exceeds the line trigger, recording a 33% deduction from the previous period. [Awaiting confirmation from Finance]

- *Other operating expenditure*

	TOTAL 16/17	TOTAL 15/16	£variance	% of Opex	%line Increase
Other opex	£6.351m	7.101m	£0.867m	5%	11%

We have undertaken a review of SEW support charges (e.g. IT, finance, HR, etc) to ensure we correctly allocate cost to the appropriate price control as per the Ofwat regulatory guidelines. This review has identified no significant change of cost allocation. Other operating expenditure has however reduced – triggering the 5% of total retail opex. This is as a consequence of resetting our pension deficit payment to align with the Ofwat information notice (IN13/17). The re-alignment has resulted in a reduced pension deficit payment charge being allocated to retail household. We believe this appropriate and provides a consistent approach across the industry to aid comparison.

2 Capital Expenditure

2.1 Background and Purpose

The purpose of this methodology statement is to illustrate the process and allocation procedures undertaken in order to calculate the capital costs necessary to complete tables; 2D (historic cost analysis of fixed assets for the wholesale and retail business), 4D (wholesale totex analysis), 4F (operating cost analysis for household retail) and 4G (analysis of wholesale current cost financial performance).

The Regulatory Accounting Guidelines (“RAGs”) require the Company to look at each individual asset and determine to which price control(s) and business unit(s), as defined by Ofwat, they belong by reference to the assets’ use. The purpose of the fixed asset accounting separation tables within the Annual Performance Report (“APR”), as stated above, are to split the entire asset register of South East Water Limited (“SEWL”) into the applicable groupings as shown in the table below:

Wholesale						Retail	
Water resources		Network+					
Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Household	Non-household

2.2 Overall Table Methodology

As prescribed by Ofwat, the Regulatory Accounts for the finance year 2017/18 have been prepared on an historic cost basis, with the exception of the financial performance reported in table 4G, which is reported under current cost accounting (“CCA”) rules.

The change from current cost accounting to historic cost accounting occurred in the 2015/16 finance year. At which stage the allocation of opening balances for cost and depreciation to business units were calculated by reference to the categories held on the fixed assets accounting system at that time.

Any alterations to the valuation of the Company's fixed assets in the current reporting year relate to additions, disposals, depreciation charged for the year and impairments to the carrying value of assets. The following describes the methodology and procedures used in preparing and adjusting the data to be entered into the tables relating to fixed assets within the Annual Performance Report. Also included below are explanations of any material movements or variances in cost which have arisen in the year.

The primary data source for the fixed asset tables is the Company's fixed assets accounting system, including the register of assets in use and work in progress, where assets currently under construction are recorded. The majority of our asset values are brought forward from the prior year.

At the end of the finance year, raw data is downloaded from our fixed assets accounting system detailing the transactions that have occurred during the year. These downloads are then converted into excel files, which in turn are used in order to calculate the figures to be entered into the Annual Performance Report.

These calculation files have been audited by our reporter, Jacobs, to provide assurance with our regulatory compliance.

2.3 Additions

Additions form a major part of both the wholesale totex analysed in table 4D and the historic cost analysis of fixed assets completed in table 2D of the APR. Additions are based on the capital spend of the Company over the past year, which is recorded in the fixed assets accounting records.

As mentioned earlier, a download is run from the Company's fixed assets accounting system which encompasses the total capital spend over the year. This data is then analysed in order to allocate the spend to the applicable price control(s) and business unit(s). In addition to this, the capital spend is analysed further in order to segregate the spend based on the nature of the capital project being completed, this enables capital spend to be split between enhancement or base and infrastructure or non-infrastructure works.

In order to allocate capital spend accurately, the Company builds the records held within its fixed asset accounting system based upon Capital Expenditure Requests ("CERs"). The CERs form the basis on which capital spend is allocated, for each capital project the project manager is required to describe in detail the nature of the expenditure and the correct regulatory allocation, including business unit, asset type and asset life. This information is then sense checked by the Capital Programme Management team and Finance department before being added to the Company's fixed asset records, ensuring capital spend is recorded against the appropriate criteria.

In addition to the checks completed on recording capital projects in the Company's fixed asset accounting records, once the download has been generated for the year, this is provided to the Capital Programme Management team who use their expertise and knowledge of the capital works in order to complete a further sense check to ensure capital spend is allocated correctly. In any instances where errors are found within the download file, they are corrected manually within the file and appropriate adjustments are later made to the records held within the Company's fixed asset accounting system.

Determining Business Unit

During the authorisation process of capital projects, project managers are required to illustrate on the CERs which business unit or units the asset being constructed will be used by. All future expenditure incurred in the construction of the asset is then allocated to the business unit(s) as specified by the project manager.

As an additional part of the authorisation process, the Finance department review each CER in order to ensure their accuracy before being recorded in the Company's fixed asset accounting system. Project data recorded within the fixed asset accounting system is periodically reviewed by both the Finance department and the Capital Programme Management team to ensure records are correct and remain up to date as part of the Company's accounting records, minimising the risk of miss reporting capital spend.

Where an asset is expected to be used by more than one business unit, it is recorded in the Company's fixed asset accounting system against the business unit expected to make the most use of the asset as stated on the relevant CER. A trigger is applied against the asset within the accounting system in order to differentiate it from assets that are expected to be used by one single business unit. Doing so enables the Finance department to easily identify projects within the system download files, where it is necessary for the cost to be apportioned between multiple business units. For these projects the data included within the download files is cross referenced to the CER in order to then pro rata the cost of the asset between the various business units as applicable, any such amendments are then reviewed by the Capital Programme Management team to ensure their accuracy.

Expenditure on projects designated as general and support is allocated to business units based on the same cost drivers as used in the opex tables and described above. Each project is assigned to a specific cost driver dependant on the asset generated from completing the project, for example, expenditure incurred in acquiring new IT software or hardware would be based on the IT cost driver.

Determining Asset Type

The allocation of capital expenditure between infrastructure, operations and other assets is based upon the information provided by the project managers when completing the CERs. If the project involves the construction of an asset which covers more than one asset type, the costs are split by asset type based on the percentage allocated to each asset type by the project manager. Again, this information would be sense checked by the Finance department as part of the approval process in order to identify any discrepancies prior to being recorded in the Company's fixed asset accounting system.

When completing the CER, the project manager must select the applicable asset type and asset life grouping depending on what asset is being constructed, this selection is limited based upon the asset in order to help ensure the accuracy of data provided by project managers. The table to be completed within the CER by the project manager is shown below.

	Asset Life	Category	Cost (£k)	% Split
INFRA	0	Surface (Impounding Reservoirs)		
INFRA	60	Meter Boxes		
INFRA	100	Mains		
OPS	Non Depreciating	Land		
OPS	0 – 10	Fixed Plant (Light)		
OPS	7	Mobile Plant		

OPS	10	Telemetry Equipment		
OPS	15 – 20	Fixed Plant (Light)		
OPS	20	Meters		
OPS	21 – 30	Fixed Plant (Light)		
OPS	35 – 60	Fixed Plant (Heavy)		
OPS	60	Wells & Boreholes		
OPS	80	Building-Non		

	Asset Life	Category	Cost (£k)	% Split
OPS	80	Service Reservoirs & Water Towers		
OTHER	3 – 5	Computer Hardware		
OTHER	3 – 7	Computer Software		
OTHER	4	Vehicles		
OTHER	5	Office Equipment		
OTHER	5	Furniture & Fittings		
OTHER	6	Lab Equipment		
		TOTAL		

Determining Asset Enhancement or Maintenance

When completing a CER, the project manager must detail as to whether the project in question relates to the construction of a new asset, the enhancement of a current asset, maintenance of a current asset or the reinforcement of a current asset as the result of new connections or developments. Though in the majority of instances assets would fall into one single category, if the project relates to the construction of an asset which falls into more than one of the above categories, the costs are split over the different categories based upon the percentage split provided by the project manager.

The information provided by the project manager would be sense checked by the Finance department as part of the approval process to ensure the accuracy of the CER before the project is recorded in the Company’s fixed asset accounting system. The data recorded in the fixed asset accounting system is periodically sense checked by the Capital Programme Management team in order to ensure its accuracy, feeding back any issues they have to the Finance department who are then able to make any changes to the accounting system as necessary.

The table to be completed by the project manager as part of the CER is shown below.

	Infra Assets %	Non-Infra Assets %	Total %
Additions – New Assets (Enhanced)			
Drinking Water Quality inc. SEMD			
Enhanced Service Levels			
Supply Demand Balance			
Base Service Provision			
Maintenance Non Infrastructure			
Maintenance Infrastructure			
Infrastructure Network Reinforcement (New Connections/Developments)			
Distribution & Trunk Mains			
Pumping & Storage Facilities			
Other			

2.4 Disposals

Disposals reported in the historic cost analysis of fixed assets (table 2D) in the Annual Performance Report represent the fixed assets sold or no longer used by the Company. These assets may or may not be replaced, a decision which is based upon the benefits gained from each specific asset which is disposed of. The assets disposed of by the business in the year are deducted from the asset balances of business units based upon the value of costs and depreciation removed from the Company's fixed asset accounting system.

In order to calculate this a download is run from the Company's fixed asset register, detailing the assets disposed of during the year along with the cost of acquisition and the life to date depreciation. This download is then analysed in order to split the cost and depreciation of disposals between the various business units.

The basis on which disposals are allocated between the different business units varies dependant on the type of asset being disposed. For instance, mains abandonments are allocated wholly to the treated water distribution business unit, whereas disposals of vehicles, IT equipment and office furniture are allocated to the relevant business units on a cost driver basis. Other types of assets are then allocated in line with the treatment of similar assets in the additions analysis.

This process allows the Company to accurately show the impact of disposals on the fixed assets held by the business, as reported in table 2D of the APR file.

2.5 Retail Table Assets

A valuation of the Company's assets was carried out in 2008 and was used as our opening balance for cost and depreciation under current cost accounting rules. This has then been analysed in order to segregate costs and depreciation between the relevant business units. The balances have been updated each year for movements, including inflation, as described above.

Prior to the valuation in 2008 no records were maintained as to the allocation of projects between business units in the Company's accounting records. With the change to historic cost accounting taking place in 2015/16, the allocation of the opening balance between Wholesale and Retail operations was based pro rata on the current cost values brought forward from the previous year. This has been tested for reasonableness by reference to the value of additions allocated to the Retail operations in the past five years as the Retail operations assets tend to be short term assets, predominantly made up of IT software and equipment and vehicles.

2.6 HCA Depreciation

For the household retail cost analysis completed in table 4F in the Annual Performance Report, depreciation charged for the year calculated on an historic cost accounting basis is split between fixed assets acquired before or after the 1 April 2015 and measured or unmeasured business.

In order to split depreciation charged for the reporting year, the opening balance of household retail assets is taken from the 2015/16 financial year, representing assets existing at 31 March 2015, and the additions for each year since are totalled in order to calculate the proportion of

total household retail assets acquired since 1 April 2015. These figures are then adjusted for any disposals since 1 April 2015, applying each asset disposed of to the relevant period based on its date of acquisition. The depreciation charge for the year applicable to the retail household business unit is then apportioned based on the proportion of the total value of retail household assets applicable to each period as calculated above.

The value of depreciation charged for each period, as prescribed in table 4F in the APR, is then split by the number of customers charged on either a metered or unmetered supply in the year. Customer data taken from the Company's billing system is analysed in order to calculate the number of customers billed over the period based on metered usage or rateable value, and is reported in the analysis of household revenues by customer type (table 2F) in the APR.

2.7 CCA Depreciation

At present the Company does not maintain a fixed asset register based on current cost accounting ("CCA") rules as part of its accounting records. Instead, in order to calculate CCA information, the Finance department uses data extracted from the Company's historic cost fixed asset register which is then analysed on spreadsheets in order to calculate the necessary CCA figures.

For the wholesale current cost financial performance analysis reported in table 4G of the Annual Performance Report, the CCA depreciation amount has been estimated.

In order to calculate the depreciation amount based upon CCA rules, the closing depreciation amount as at 31 March 2015, being the final year in which CCA rules were applied by the Company, is uplifted by average RPI for each year since. In addition to this, the depreciation charged for the year 2014/15 is also uplifted by the rate of RPI at 31 March for each year since its original calculation. Lastly, depreciation occurring during the reported year on additions is added and disposals is taken away from the product of the previous two calculations to arrive at the total current cost depreciation charge for the reporting year.

2.8 Contributions

In view of the change in the accounting for contributions in the Company's financial accounts with the adoption of IFRS and the new style of reporting required by Ofwat with the introduction of the APR, the recognition of capital contributions has changed.

In previous AMPs, the Company's treatment of contributions within the financial accounts was that contributions were held on the balance sheet as a liability when they were received until work began on the project to which they related, whereupon they were released as an offset against the costs of the project. It was the amount released that was accounted for in the regulatory accounts as an offset against capital costs regardless of when the contribution was received.

In the Company's financial accounts for the current AMP, contributions are still initially taken to the balance sheet as a liability on receipt but are no longer released against capital costs when work on the project begins, rather when the work to which the contributions relate has been completed, they are amortised over the life of the underlying asset as income in the income statement.

The Company's approach to recording contributions in the regulatory accounts differs from that of the financial accounts. As the economic life of the relevant asset is often 100 years, it was decided that it was more appropriate for the regulatory accounts for contributions to be recognised and offset against totex in the year in which they are received.

2.9 Analysis of Fixed Asset Movements

The following tables and accompanying explanations detail the major differences between the fixed asset movements in the current reporting year compared to the previous year. The financial data analysed below has been prepared following historic accounting rules.

The table below compares additions in the year to the previous year based on historic costs.

Description	2018 £m	2017 £m	Variance £m	Variance %
Water Resources additions	5.2	7.0	(1.8)	(25.7)
Network+ additions	87.4	78.7	8.7	11.1
Retail additions	1.2	1.8	(0.6)	(33.3)
Total additions	93.8	87.5	6.3	7.2

The mix of asset types attracting capital expenditure changes from year to year. The spending in the Retail business continues to be mainly on IT software and equipment. There are no specific changes in the mix of spend from last year to the current year.

The table below compares disposals in the year to the previous year based on historic costs.

Description	2018 £m	2017 £m	Variance £m	Variance %
Water Resources disposals	(0.1)	0.0	(0.1)	100.0
Network+ disposals	(1.1)	(0.4)	(0.7)	175.0
Retail disposals	(0.1)	(0.1)	0.0	0.0
Total disposals	(1.3)	(0.5)	(0.8)	160.0

The significant increase in disposals in the Wholesale business, specifically within Network+, is largely due to an increase in the acquisition costs of assets disposed during the year.

The table below shows a comparison of depreciation between the past two years on an historic cost basis.

Description	2018 £m	2017 £m	Variance £m	Variance %
Water Resources disposals	0.0	0.0	0.0	0.0
Network+ disposals	0.8	0.3	0.5	166.7
Retail disposals	0.1	0.1	0.0	0.0
Water Resources charge for the year	(7.2)	(6.7)	(0.5)	(7.5)
Network+ charge for the year	(42.2)	(39.6)	(2.6)	(6.6)
Retail charge for the year	(0.1)	(0.1)	0.0	0.0

The increase in depreciation on disposals is broadly in line with the increase in assets disposed of and reflects the largely depreciated nature of those assets.

The depreciation for year is broadly in line with the prior year, as would be expected given the relatively stable asset base.

Contact Us

South East Water
Rocfort Road
Snodland
Kent
ME6 5AH
Tel: 0333 000 2244

southeastwater.co.uk

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