

ACCOUNTING SEPARATION 2015/16

For inclusion in Annual Performance Report Year ended 31st March 2016

PORTSMOUTH WATER LTD METHODOLOGY STATEMENT 2015/16

Governance Process

The Accounting Separation analysis has been prepared by the Management Accountant and reviewed by the Financial Controller. The allocation of direct costs between Wholesale and Retail has been reviewed and agreed by the Distribution Manager; this is mainly Inspectors, Distribution Administration and the Operations Centre. The allocation of Retail costs between the direct activities has been reviewed and agreed by the Head of Retail.

The Finance & Regulation Director has done a final review of the Accounting Separation allocations, and approved the data for inclusion in the Annual Performance Report.

Methodology Statement for Accounting Separation

This statement details the systems in place and the sources of information used to populate the Accounting Separation Tables in the Annual Performance Report.

The Company's detailed nominal ledger management information reports allow costs to be identified for each cost centre in the Company and therefore the direct costs of each business unit (e.g. Water Resources/Treatment) can be built up using the reports. The management reports allow for separate identification of direct costs relating to the Retail functions of the business. The general and support costs of the business are not allocated by business unit in the nominal ledger and it is therefore necessary to use methods of allocation to be able to provide this level of detail.

Portsmouth Water currently use a mainframe accounting system. However, an ERP system is currently being designed and the Accounting Separation requirements for the Annual Performance Report will form a fundamental basis to the new coding structure. In preparing this methodology new technologies and their enhanced functionality have been considered.

The Ofwat Accounting Separation guidance (RAG 2.05) has been followed, in the separating of costs for the reporting of figures in the segmental Wholesale and Retail tables. A line by line commentary as to how costs have been allocated is provided below.

The allocation of indirect costs between business unit areas is carried out by using the Company's management information reports, detailed above. Some of the indirect costs are capable of being charged directly to business units; however with some indirect costs centres it is necessary to make an allocation between business units using an appropriate cost driver. (E.g. direct material costs for the allocation of stores department costs)

The Company has followed the guidance issued by Ofwat relating to the allocation of assets and costs between business units. It has followed Ofwat's hierarchy of cost drivers when deciding upon the most appropriate basis for allocation of both assets and costs.

The Company has allocated a small number of costs on a management estimate basis. Where it has chosen to do so the Company is satisfied that this was the only valid option at this time. However, it is looking to minimize this further with the implementation of the new integrated asset and finance system (IFS). Senior departmental managers provided the allocation percentages for these items, using the Business Unit descriptions, and these percentages have been reviewed and updated to reflect any changes in the business in the current year.

ACCOUNTING SEPARATION 2015/16

See Appendix 1 for a summary of the cost allocation by business unit, and Appendix 2 and Appendix 3 for the Wholesale and Retail cost summaries.

Operating Cost Analysis (Wholesale Business only)

The Wholesale Business of the Company consists of the following Business Units: Water Resources, Raw Water Distribution, Water Treatment and Treated Water Distribution.

Management estimate percentages used in 2014/15, and referred to below, were reviewed and remain unchanged for 2015/16.

Direct Costs

Employment Costs Distribution: Employment costs are treated in two separate ways in terms of allocation to cost centres and activities. Costs of employment for employees who complete timesheets have been directly allocated to the relevant cost centre and work activity, and can then usually be allocated directly to a business unit. Employment costs of employees who do not complete timesheets (mainly supervisors who work on an indirect basis) have been split on the basis of a management estimate (Distribution Manager) of time spent working for each business unit. The majority of employees carry out work in relation to a number of business units.

In the new IFS system, all direct employees will either complete a timesheet, or if they a supervisor or manager they will have their costs allocated to the chargeout rates of their direct reports. Direct employees will book time to specific assets, which will allow for more accurate allocation of this cost.

Direct employment costs coded to cost centres which are split between Wholesale and Retail functions have been allocated as follows:

Inspectors

These costs are allocated to either Treated Water Distribution or Retail. Costs of meter reading, debt recovery/disconnections consultations with customers, query/complaint investigations (which turn out to be on the customer side of the network) and customer-side leaks are directly allocated by timesheets and charged to Retail. All other direct costs, allocated by timesheets, relate to Treated Water Distribution. Office work and administration costs are allocated to Retail on the basis of a management estimate, which is 30% and relates to the number of staff doing Retail activities, and the rest is allocated to Treated Water Distribution.

In IFS meter readers (Assistant Inspectors) will have their own department code, and this will enable office work and administration to be almost completely directly allocated between Retail and Wholesale.

Distribution Administration

These costs are allocated to either Treated Water Distribution or Retail.

Management salaries are allocated to Retail on the basis of a management estimate (Distribution Manager), which is 20%, and the rest is allocated to Treated Water Distribution.

In IFS, management and supervisors will have their costs added to the chargeout rates of their direct reports. No management estimate will be needed.

Leakage and Byelaw enforcement salaries are allocated 100% to Treated Water Distribution. The remaining costs relate to 4 office staff, of which 1 works 100% for Wholesale and the other 3 work 100% for Retail.

ACCOUNTING SEPARATION 2015/16

In IFS these staff will complete timesheets and allocate their time to Customer Contact Network and Wholesale activities.

Operations Centre

Costs are allocated to all business units on the basis of the activities that the centre performs at different times of the day. This includes a 30% allocation to Retail, which represents the service that is provided to customers who call outside normal working hours.

In IFS these staff will complete timesheets.

Mains & Services and Company Reinstatement

These costs are mainly allocated to Treated Water Distribution. However, the costs of any customer-side leak repairs are allocated to Retail.

Power: Power costs reported here mainly relate to treatment works & pumping stations, including borehole sites, and are 100% Wholesale. Power has been allocated on the basis of the assets that consume it. Each individual location is billed, invoiced and coded separately and bills provide the data for consumption and cost by location. Each of these costs is reported by location in the nominal ledger reports.

Where a pump asset consumes power for a dual purpose, a split based on pumping head has been used to allocate the cost between the functions. These dual functions are mainly water resources abstraction and treated water distribution, but in some cases water treatment is a significant function and so consumes a proportion of the power. Where water treatment is a minor element (simple chlorination) of the asset function, then a 1% management estimate has been used to allocate costs to this business unit.

An allocation of costs for the Bulk Supply of water to Southern Water has been based on the pumping head at Slindon to Whiteways Lodge reservoir. 44% of power costs have been allocated to the Bulk Supply.

These pumping head figures have been revised and updated for 2015/16.

Pumping Head Allocation

	Distribution	Resources	Treatment Works	Bulk Supply	Total	Distribution %	Resources %	Treatment Works %	Bulk Supply %
Eastergate	36.66	11.73			48.39	76%	24%	0%	0%
Slindon	22.61	73.40		74.78	170.79	13%	43%	0%	44%
Westergate	37.51	12.15			49.66	76%	24%	0%	0%
Brickkiln	18.58	22.15			40.73	46%	54%	0%	0%
Fishbourne	68.42	4.36	28.50		101.28	68%	4%	28%	0%
Lavant	38.72	11.91			50.63	76%	24%	0%	0%
Funtington	40.92	22.15			63.07	65%	35%	0%	0%
Walderton	34.65	7.93			42.58	81%	19%	0%	0%
Lovedean	9.71	18.97	11.00		39.68	24%	48%	28%	0%
Worlds End	52.32	28.12			80.44	65%	35%	0%	0%
Woodmancote	35.03	22.41			57.44	61%	39%	0%	0%
West Meon	57.79	29.91			87.70	66%	34%	0%	0%
Northbrook	44.34	49.20			93.54	47%	53%	0%	0%
West Street	20.44	11.99			32.43	63%	37%	0%	0%
Maindell	80.22	12.76			92.98	86%	14%	0%	0%
Soberton	19.80	34.49	28.50		82.79	24%	42%	34%	0%
Havant	0.00	9.23			9.23	0%	100%	0%	0%
Bedhampton 1 & 2	0.00	9.23			9.23	0%	100%	0%	0%
Aldingbourne	46.26	13.93			60.19	77%	23%	0%	0%
Newtown	48.07	114.48			162.55	30%	70%	0%	0%
Lower Upham	43.42	76.35			119.77	36%	64%	0%	0%
	755.47	596.85	68.00	74.78	1,495.10	53%	42%	5%	
AVERAGE PUMPING HEAD						53.2%	42.0%	4.8%	

ACCOUNTING SEPARATION 2015/16

Pumping costs from Havant and Bedhampton to Farlington Treatment Works are classed as Raw Water Distribution, as the raw water is transported to a different site for treatment.

Employment Costs Supply: Direct Costs booked to pumping stations are allocated between business units on a management estimate, which reflects to high proportion of time spent at the Treatment Works. 90% of time is allocated here. Supervisor costs are allocated to sites on the basis of a management estimate.

In IFS this direct labour will be charged to specific assets via work orders and a more accurate allocation of costs will be possible. Supervisors will be added to the chargeout rate of their direct reports.

Hired and Contracted Services: As per the guidance these costs have been allocated directly where possible and on the basis of pumping head for costs relating to pumping stations.

Materials & Consumables: These costs have largely been identified as directly attributable to individual business units. However, management estimates of time spent carrying out the activities of the different business units were used to enable Inspectors, Distribution Administration and Operations Centre costs to be allocated to individual business units, and in particular between Wholesale and Retail. The exception to this is Assistant Inspectors who carry out meter reading, which is a Retail function, and 100% of their materials costs have been allocated to Retail.

Materials relating to customer-side leaks are all allocated to the Retail business unit. Chemicals are all allocated to Water Treatment.

Service Charges: This relates to abstraction charges and has therefore been allocated directly to Water Resources.

Other Direct costs: These were largely attributable to individual business units. However, management estimates of time spent carrying out the activities of the different business units were used to enable Inspectors and Distribution Administration costs to be allocated to individual business units.

Operating Expenditure

General and Support Expenditure: This covers a range of costs that have each been identified and allocated in the following ways. Timesheets have not been introduced in any of the areas below, due to the complexity of the work and general nature of many of the activities. **However, this can be reviewed after the implementation of IFS.**

Land & Property: The nominal ledger structure allows these costs to be largely directly identifiable by location. The costs that are directly attributable to individual business units have been identified and other associated costs not directly attributable have been allocated on a pro rata basis of those directly allocated.

Retail costs have been separately identified as a percentage of those costs relating to the Head Office only. The percentage allocated to Retail is based on the floor space occupied by the Retail function at the Head Office.

Mechanical & Electrical: The nominal ledger structure allows these costs to be largely directly identifiable by location. The costs that are directly attributable to individual business units have

ACCOUNTING SEPARATION 2015/16

been identified and other associated costs not directly attributable have been allocated on the basis of the management estimate of time spent working for each business unit by the employees of that department.

Retail costs have been separately identified as a percentage of those costs relating to the Head Office only. The percentage allocated to Retail is based on the floor space occupied by the Retail function at the Head Office.

Supply Engineer: These represent the cost of the Supply Manager and related overheads. The costs have been split based on the same allocation as Mechanical & Electrical costs.

In IFS these costs will be allocated to the chargeout rates of all the direct reports who complete timesheets.

Supply General: The supply general costs were allocated directly where possible to individual business units. The remaining costs include the running costs of the Company's Telemetry system, and have been split based on the same allocation as Mechanical & Electrical costs.

Distribution General: Costs are allocated between Treated Water Distribution and Retail based on the management estimate of time spent carrying out associated activities by Distribution Administration staff.

HR: HR costs have been split on the basis of FTE's in each business unit, as per the issued table guidance. These costs include Staff Welfare. However, any costs relating to Water Efficiency have been directly allocated to Retail.

Company Secretary: These costs have been split on the basis of FTE's in each business unit, as per the issued table guidance. **This is a change from 2014/15 to comply with the new guidance.**

Financial Services: Financial Services costs have been split on the basis of FTE's in each business unit, as per the issued table guidance. **This is a change from 2014/15 to comply with the new guidance.**

IT: The allocation of costs is direct for mainframe costs, where the mainframe system time can be analysed, and then on the basis of number of **computers and mobile devices** in each Business Unit, for the remaining expenditure. **In 2014/15 we only used number of computers, so this is a change to comply with the new guidance. Customer services will be affected by this change, as they have 2 computers/devices on each desk.**

Operational & Technical support: Allocation of costs by business unit is now on GMEAV for Planning, and 100% Treated Water Distribution for the Drawing Office, as these costs are mainly related to the distribution network. **This is a change from 2014/15.**

Vehicles & Plant: These costs, as per the table guidance, have been allocated on the basis of number of vehicles for the Wholesale and Retail split and on the NBV of vehicle and plant fixed assets for allocation between Wholesale business units. Motor vehicle insurance is included in these costs. (The motor fleet is insured through one premium with no vehicles being listed separately)

Materials Storage: As per the guidance this has been split on the basis of the allocation of direct costs of materials and consumables.

ACCOUNTING SEPARATION 2015/16

Pension Costs (salaried staff): The costs of this have been split based on the employment costs of each department and added to these costs for allocation. This includes the costs to Portsmouth Water of the Defined Benefits and Defined Contributions schemes.

In IFS this will be coded to each department at source.

National Insurance costs: This is allocated on the basis of employment costs. Employment costs of salaried employees were collated by department. The NI charge was then allocated to business units using the same methods as was used for the costs of each of the individual departments.

In IFS this will be coded to each department at source.

General Administration: The remaining general administration costs have been allocated directly to an individual business unit where possible. However there are a number of costs that cannot be allocated directly, the treatments of these are as follows:

- Head Office utilities and costs: These have been split on the basis of floor area by business unit.
- Directors' salaries and related costs: Allocation for the Executive Directors is based on a management estimate of time spend on activities, including an analysis of Board Agenda. Allocation for the Non-Executive Directors is based on the Board Agenda analysis only. [This is a change from 2014/15, to comply with the new guidance.](#)
- Secretaries' salaries and related costs: Allocation based on the number of FTE's in each business unit. There is a secretarial office to deal with the secretarial needs of the Company.
- Slow moving stock provision: Allocated on the basis of the direct allocation of materials and consumables.
- Professional fees, subscriptions, photocopying, audit costs and other miscellaneous general expenditure: These has been allocated on the basis of FTE's. [This is a change from 2014/15, to comply with the new guidance. Not all these costs were previously allocated using FTE's.](#)
- Insurance costs: Allocation of insurance costs is directly to a business unit where possible, and based on FTE's by business unit for the policies relating to employee liability and directors' and officers liability. The remainder relates to building and contents insurance and is split on the floor space allocation between Retail and Wholesale.
- Promotional Strategy: These costs are allocated entirely to Retail.
- Print Room: 30% of these costs have been allocated to General Business, and relate mainly to the Statutory Accounts and the Scheme of Charges booklets. These costs have then been further allocated on the basis of FTE's. 70% of the costs have been allocated to Retail and relate mainly to customer billing. [This is a change from 2014/15 and is believed to be more cost reflective.](#)

ACCOUNTING SEPARATION 2015/16

Scientific Services

The costs of Scientific Services have been split based on a management estimate of water samples taken for each business unit. The exception is Catchment Management, which is allocated entirely to Water Resources, as per the Ofwat guidance.

This estimate was updated for 2015/16, to reflect changes in the business.

Other Business Activities

The costs of regulation have been allocated directly to Business Units where possible, and evenly across all 5 business units for any remaining costs, as per the table guidance.

Local Authority Rates

As per the table guidance the costs of local authority rates are split on Floor Space. This includes the Head Office site, Farlington and Itchen treatment works, Pumping Stations and Booster Stations.

This is a change from 2014/15, to comply with the new guidance. Previously we used asset value to allocate these costs and this gave 0.3% of costs to Retail. Now, the allocation to retail is around 8%, an increase of £157k.

Third Party Services Opex

These costs relate directly to both the bulk supply of treated water to Southern Water Services and the costs of the distribution department for rechargeable works. These have therefore been directly allocated.

Infrastructure Renewals Charge

This has been allocated directly to Treated Water Distribution and reflects the long term costs of maintaining the distribution network. This figure has been used in the Current Cost Table only in the Annual Performance report.

Current Cost Depreciation

This allocation comes directly from the detailed current cost fixed assets spreadsheets.

The allocation bases above are considered the most appropriate treatment for each of the cost areas. Management has taken consideration of the cost, time and appropriateness of other possible allocation methods and has decided that the above treatments are the most appropriate for the Company to follow at this time.

The treatment of direct costs and operating expenditure is consistent with the treatment of the relevant fixed assets for allocation purposes.

Operating Cost Analysis (Retail Business only)

The Retail Business is located at the Head Office of the Company in Havant and consists of the following functions:

Customer Services Department (including Debt Recovery, Postage and Visiting Officers)

Commercial Manager (70% of costs are Retail)

Print Room (70% of costs are direct Retail)

Bad Debts Provision

% of Inspectors (see Wholesale allocations)

ACCOUNTING SEPARATION 2015/16

% of Distribution Administration (see Wholesale allocations)
% of Operations Centre (see Wholesale allocations)
Customer-side leaks
% of Other Business Activities (Regulation)
% of Head Office costs (Land, Property and Mechanical & Electrical)
% of General and Support costs

Direct Costs

The methodology above for the Wholesale business identifies the direct costs of employment, materials and consumables and other direct costs which have been allocated between Wholesale and Retail. These relate to the costs of Inspectors, Distribution Administration and Operations Centre, as well as customer-side leaks.

In addition, there are costs which are direct Retail costs and can be identified from the company nominal ledger reports. These are as follows:

Customer Services Department (including Debt Recovery and Postage)
Commercial Manager
Bad Debts Provision

Below is a line by line description as to how the direct costs have been allocated to the Retail activities and then allocated between Household & Non-Household for each activity. In addition, the costs within Household Retail are allocated between Measured and Unmeasured customers, to populate the new table 4F.

In the Annual Performance Report the operating expenditure for Retail is in a less detailed format, with one line for 'Customer Services' and another for 'Other Operating Expenditure'. The definition of these line items is in RAG 4.05 and has been followed.

Customer Services is the sum of the following activities:

Billing
Payment Handling, Remittance and Cash Handling
Non-network Customer Enquiries and Complaints
Network Customer Enquiries and Complaints

Other Operating Expenditure is the sum of the following activities:

Disconnections (customer contact only and not the physical disconnection)
Demand Side Water Efficiency Initiatives
Customer Side Leaks
General and Support expenditure
Other Business Activities

Billing: Direct employment costs of Customer Services staff are allocated to Billing, as well as 70% of Print Room staff costs. Customer Services stationery is allocated 100% to Billing activities and Postage is allocated to Billing on the basis of number of bills sent. 33% of General Management costs are allocated to Billing. An allocation of stationery is made from the Print Room and the Photocopy Room, as well as 25% of the software licence costs.

The total Billing cost has been allocated between household and non-household on the basis of the number of bills issued in these areas, as per the table guidance. This basis has also been used to allocate Household costs between Measured and Unmeasured customers.

ACCOUNTING SEPARATION 2015/16

Payment Handling, Remittance and Cash Handling: Direct employment costs of Customer Services staff are allocated to this activity, as well as a proportion of Finance Services staff. Contract repairs & maintenance is allocated here and 25% of the software licence costs.

These costs have been allocated to household and non-household on the basis of the number of payments made for each area, as per the table guidance. The Household costs are then allocated between Measured and Unmeasured customers on the basis of number of bills raised.

Debt Management: Employment costs of the Customer Services Debt Recovery staff have been allocated to this activity, as well as Debt Recovery Commission from third parties. Postage costs have been allocated to this activity and represent the remaining costs after the allocation to Billing. 25% of the software licence costs have been allocated here, as well as 33% of Management salaries.

The allocation between household and non-household is based on the debt outstanding > 30 days for each, at the end of March 2016. The same basis is used to allocate the Household costs between Measured and Unmeasured customers.

Doubtful Debts: Costs are allocated directly to this activity.

The allocation between household and non-household is a direct allocation.

For 2015/16 the total amount of Doubtful Debts is £810k. This is split as follows:

Unmeasured Doubtful Debts	£523k	> 99% household
Measured Doubtful Debts	£287k	household and non-household

The Measured Doubtful Debts provision amount is calculated separately for household and non-household customers, considering the relative risk of each.

The remainder of the calculation relates to an allowance for the movement in total debt written off, which can also be directly allocated to household and non-household customers.

Vulnerable Customer Scheme: There is no material cost associated with the administration of the vulnerable group scheme.

Non-network Customer Enquiries and Complaints: Direct employment costs of Customer Services staff are allocated to this activity, as well as 33% of General Management and 100% of the Commercial Manager. 25% of the software licence costs are allocated to this activity and a proportion of telephone costs from General and Administration.

The allocation between household and non-household is based on the number of non-network customer contacts recorded for each business unit, as per the table guidance. The same basis is used to allocate the Household costs between Measured and Unmeasured customers.

Meter Reading: Direct employment costs of Inspectors and Assistant Inspectors are allocated to this activity, as detailed in the Wholesale commentary above, as well as Distribution Administration meter reading supervision. Associated motor transport costs are also allocated here. The costs are partially offset by Billing Commission income from Southern Water.

The allocation between household and non-household is based on the number of meter reads in each business unit, as per the table guidance. All costs are allocated to measured customers.

ACCOUNTING SEPARATION 2015/16

Network Customer Enquiries and Complaints: Direct employment costs of Inspectors, Distribution Administration and the Operations Centre are allocated to this activity as well as other associated direct costs.

The allocation between household and non-household is based on the number of network customer contacts recorded for each business unit, as per the table guidance. The same basis is used to allocate the Household costs between Measured and Unmeasured customers.

Disconnections: Direct employment costs of Inspectors carrying out customer consultations for this activity are allocated here.

These costs are allocated directly to non-household.

Demand Side Water Efficiency Initiatives: These costs are directly identifiable and allocated to this Retail activity. The costs include Water Efficiency and Promotional Strategy.

They are allocated to household and non-household on number of efficiency measures. Household costs are allocated to Measured and Unmeasured customers on the basis of number of customers in each category.

Services to Developers: These costs are the salary costs of staff who deal directly with developers with regard to new services, and the associated supervisory costs. They are allocated directly to this Retail activity.

All costs relate to non-household customers only.

Customer Side Leaks: These costs are directly identifiable and allocated to this Retail activity as described in the Wholesale commentary above.

All costs relate to household customers only. Costs are allocated to Measured and Unmeasured customers on the basis of number of customers in each category.

Other Direct Costs: No costs have been allocated on this line.

General and Support expenditure: These costs represent the remaining costs not identified as being direct and their allocation between the Wholesale and Retail business units is described above.

They have been allocated between household and non-household on the basis of customer numbers. The Non-household retail business is very small for Portsmouth Water, and staff generally deal with household and non-household accounts. In addition, this business has been sold to Castle Water, who will take full responsibility for it on 01/04/17.

Household costs have been allocated between Measured and Unmeasured customers on the basis of number of customers in each category.

Scientific Services

There is no allocation of costs to the Retail business unit.

Other Business Activities

The costs of regulation have been split evenly across all 5 business units, as per the table guidance. The 20% of cost allocated the Retail is split between household and non-household on the basis of customer numbers in each.

ACCOUNTING SEPARATION 2015/16

Local Authority Rates

These costs are allocated on the basis of floor space. This includes the Head Office site, as well as the other depots and pumping station buildings.

Third Party Services

There are no identified third party services for Retail.

Current Cost Depreciation

This allocation comes directly from the detailed fixed asset spreadsheets.

The Company's management is satisfied that the costs and allocation methods used in the Retail Operating Cost are the most appropriate. The guidance has largely been followed and on occasions where this is not the case, the Company has used its judgement to produce the most appropriate methods of cost allocation in order to give accurate cost allocations.

Changes in Retail Costs > 10%

As per the Ofwat guidance, below is a summary of the Retail costs which have changed by >10% since last year, and an explanation of the differences.

Overall, Retail operating costs have increased by 1%, but there have been some large movements between categories, due partly to revised allocation methods.

	<u>Change 2015 vs 2016</u>
Customer Services	3%
Debt Management	0%
Doubtful Debts	-28%
Meter Reading	-21%
Services to Developers	-1%
Other Operating Expenditure	12%
Local Authority Rates	7850%

Doubtful Debts decreased by 28% due to a change in the policy for this provision in the previous year, which made 2014/15 much higher than normal.

Meter Reading costs decreased by 21% (£29k). This is due to a refinement in the allocation of costs. Check Meter Reading and Hi/Low Investigation are Wholesale activities, and not Retail (-£78k). There is also a decrease in commission costs received from Southern Water (£16k). In addition, there have been more hours booked to meter reading by the assistant inspectors, due to additional meters from new properties and meter optants (£36k).

Other Operating Expenditure has increased by 12% mainly due to an increase in professional fees in the year and the allocation of IT costs (now on number of computers and mobile devices). Each customer service individual has 2 computers on their desk. Also, there is an increase in the Retail costs of Land & Building and M&E, due to increased costs at Head Office, of which it has a 47.1% share, based on floor space. Retail National Insurance costs have also increased by 14%.

Local Authority rates increased by £157k, from £2k. The guidance for the allocation of these costs changed in RAG 2.05 and we now use floor space to allocate these costs. Previously, we used GMEAV of all assets, which allocated only a small % of costs to Retail. Retail occupies 21.7% of the Head Office site and so is now allocated a greater proportion of the costs.

ACCOUNTING SEPARATION 2015/16

Current Cost Analysis of Fixed Assets (Wholesale and Retail)

Portsmouth Water keeps current cost fixed asset ledgers for all categories of fixed assets. The assets contained within these ledgers are separately identified and are updated on an annual basis. Capital expenditure comprises expenditure on overground assets plus new mains expenditure and the purchase of vehicles, computers and small plant items (including meters).

The disaggregated fixed asset tables require the separation of assets into each of the 5 business units, with a further separation of the retail assets between household and non-household categories. The current cost fixed asset registers have been arranged in order to classify the existing assets into the relevant business units for Accounting Separation reporting purposes. The asset additions are assessed prior to addition to the ledger, to determine which business unit they belong to. The Ofwat business unit definitions have been used as a guide for the asset allocations.

The current cost fixed asset ledgers are maintained on Excel spreadsheets and the data is therefore flexible to the specific adjustments required to Accounting Separation tables. Look up functions and 'if' statements have been used in order to produce, within Excel, a version of tables for each of the asset types maintained in the current cost fixed asset ledgers. Each line in the fixed asset registers are linked into a formula that looks up the asset values, depreciation and the business unit classification. The individual tables created in Excel are then amalgamated to produce the required inputs for the Accounting Separation tables.

The CCA asset register will be uploaded to the new IFS system and automated in the future. This will be maintained until further guidance from Ofwat.

As required by Ofwat from 2012/13, all assets have been allocated to either a Wholesale business unit or Retail, depending on the business unit of principal use. Consequently, the Retail Fixed Asset table in the Regulatory Accounts now only contains assets that are directly allocated to the Retail business unit, and any shared assets have been identified and it was decided that Treated Water Distribution in Wholesale was the most appropriate business unit to be the one of principal use.

Where an asset has been allocated entirely to Wholesale, but provides a tangible benefit to Retail, a recharge has been calculated and is included in the total Retail operating costs, while reducing the Wholesale operating costs.

An analysis of the assets allocated to Retail, and associated current cost depreciation costs are in Appendix 4.

Asset Allocations between Business Units

Infrastructure Assets

Infrastructure Assets have been allocated directly to either Raw Water Distribution or Treated Water Distribution. The assets as at 31st March 2008 had already been categorised as either Raw Water aqueducts or as Potable Water Mains as part of the PR09 process in table B7.13 of the Company's Final Business Plan submission. Infrastructure asset additions beyond this date have been assessed as to the business unit that they belong in. All additions are directly allocated.

Other Tangible Assets, Vehicles

The Fixed Asset Schedules used in the preparation of these tables itemise each vehicle by registration reference. This enables the drivers and users of these vehicles to be identified. Where applicable, the vehicles have been allocated to one single business unit. Where direct allocation of vehicles to single units was not possible then a consistent approach to allocation has been taken to that of the relevant operating costs.

ACCOUNTING SEPARATION 2015/16

Other Tangible Assets, Small Plant & Meters

The Small Plant Current Cost Fixed Asset ledger has been analysed and those plant items that were directly identifiable as being used for the purpose of only one business unit have been allocated directly to that business unit. There are a number of small plant asset types that related to company departments whose activities straddle the business units. These assets have been allocated on the same basis as the related operating costs.

Operational Assets

Operational assets have been directly allocated to a single business unit where possible. Where this was not possible assets have been allocated on bases consistent with the guidance document:

Offices & Depots

Where business activities straddle the business units the assets have been allocated on a consistent basis with that of other assets that are utilised by the same department.

The Head Office has been allocated on the basis of floor area & then sub allocated either directly to a single business unit or has been proportionally allocated based on management estimates for shared service areas. For example, the Laboratory office space has been proportionally allocated between business units on the same bases that the Laboratory equipment has been allocated by. All other offices and depots have been allocated either directly or on the basis of management estimates (as above).

Land

Land values have largely been identified as attributable to one business unit. Ofwat's Knowledge Management Team has provided advice regarding a number of sites and as to how they should be allocated for the purposes of asset separation. Portsmouth Water has followed this guidance.

Where land is utilised for the purposes of more than one business unit, the land has been allocated accordingly. Technical drawings of the sites have been provided by the Company's Drawing Office and these have been used to allocate the land to each business unit necessary on the bases of floor area.

Service Reservoirs and Treatment Works

These assets have been allocated directly to individual business units.

Pumping Stations

Pumping station assets have been allocated directly to individual business units, where possible, using the asset inventory category mapping tables supplied by Ofwat. These allocations have been verified by the Supply Manager. There are only a small number of assets that required allocation to more than one business unit, due to the fact that they carry out activities that are for the benefit of multiple business units.

Telemetry Assets

These have been allocated to a number of business units on the basis of a Management estimate produced by the Supply Manager and the Management Accountant.

Retail Household and Non-Household Allocation

The allocation of asset values between Retail Household & Retail Non- Household business units is on the basis of the number of properties in the financial year. This basis for allocation ensures that assets have been allocated in a manner broadly consistent with the associated operating cost.

ACCOUNTING SEPARATION 2015/16

Historic Fixed Asset Ledgers

New tables in the Annual Performance Report require direct Retail assets to be identified, and their associated depreciation. In addition, assets where there is a recharge to Retail from Wholesale (the principal use Business Unit) need to be identified. This has been done by copying the treatment of the assets in the Current Cost Fixed Assets Ledgers and assigning the relevant Business Units.

Household Retail assets and depreciation are allocated to the Measured and Unmeasured categories on the basis of customer numbers, except for vehicles relating to meter reading, which are all allocated to measured customers, as per the Ofwat guidance.

Capitalisation Policy

The Company classifies costs as either capital expenditure or operating expenditure based on a number of factors. These include the value, nature and purpose of the expenditure.

There are no formal procedures for the classification of costs to either operating expenditure or capital expenditure, due to the size of the company, the number of staff involved in the accounting process and the operating procedures that the company follows.

A detailed capital programme is drawn up each October for the coming financial year. This is approved by the Company's Board and incorporated into the Company's Budget. Following Board approval individual schemes are programmed for the coming year by Project Managers responsible for delivering the schemes. The Project Managers are responsible for the control of expenditure on the schemes and authorise each individual item of expenditure incurred. The Financial Controller reviews the scheme expenditure in order to ensure that the correct accounting treatment has been applied.

On a monthly basis the capital expenditure relating to the board approved capital schemes is reviewed by the Financial Controller, prior to submission to the Board of a monthly capital statement which shows authorised amounts. This report details the expenditure by scheme. Any material variances are investigated and resolved.

For small plant & equipment and vehicles a list is drawn up and approved by the Company's Board. Purchases made are reviewed to ensure that these are all capital items. The policy adopted by the company is that only items above £500 are capitalised.

Any items purchased in the year that are not on the approved capital list need to be sent to the Board for approval.

The Financial Controller reviews the small plant and vehicle additions on a monthly basis prior to entering the additions onto the asset records. This process is audited twice a year as part of our statutory audit, by our nominated auditors Saffery Champness. Capitalised costs include contractor invoices, stores issues, direct labour charged to schemes plus on-cost recovery and the design and supervision staff costs related to project management.

The Executive Directors ensure that the capitalisation policies and procedures adopted by the business are being operated correctly and that they are fit for purpose by regular review of the business processes and by the reviewing of the capital scheme expenditure totals on a monthly basis. The Finance Director and Financial Controller ensure that the company complies with the current accounting standards applicable to the Company.

Prepared By: C Jemphrey

Date: 16.05.2016

ACCOUNTING SEPARATION 2015/16

Appendix 1: Allocation of Operating Costs to Business Units

ANNUAL PERFORMANCE REPORT - BUSINESS UNIT TABLES
2015/16

DATE: 17-May-16

	Water Resources	Raw Water Distribution	Water Treatment	Treated Water Distribution	Retail	Total
	£000	£000	£000	£000	£000	£000
<u>DIRECT COSTS</u>						
Employment Costs	9.9	5.0	377.1	2,137.2	303.4	2,832.6
Power (add climate change levy)	387.0	316.5	233.2	1,035.9	-	1,972.6
Hired & Contracted Services	3.3	0.5	3.6	614.5	139.3	761.2
Materials & Consumables	0.1	-	246.5	667.1	10.7	924.5
Service Charges	1,322.7	-	-	-	-	1,322.7
Other Direct Costs	38.4	-	10.3	266.8	1,524.2	1,839.6
Total Direct Costs	1,761.4	322.0	870.7	4,721.5	1,977.6	9,653.2
<u>GENERAL & SUPPORT ACTIVITIES</u>						
Land & Property (direct and prorata)	75.690	1.336	160.247	152.288	58.947	448.508
Mechanical & Electrical (direct and prorata)	216.468	0.361	338.154	329.513	21.178	905.674
Supply Engineer (on M&E basis)	16.054	0.027	25.079	24.438	1.571	67.169
Supply General - Direct Allocation	13.370	0.022	72.272	20.352	1.308	107.324
Distribution General & Admin (Network staff)	-	-	-	11.215	-	11.215
Personnel Services (FTE's)	16.076	4.287	56.803	163.265	160.247	400.678
Legal & Property (FTE's)	4.557	1.215	16.102	46.282	33.116	101.272
Financial Services (FTE's)	16.427	4.381	58.042	166.825	119.369	365.044
Directors (Activity and Board Agenda)	61.910	13.658	84.204	262.629	199.190	621.591
Data processing (direct and no of devices)	40.841	9.282	144.802	292.388	394.622	881.935
Operational / Technical Support (GMEAV)	1.061	1.367	45.003	291.397	-	338.828
Vehicles & Plant (Closing NBV of assetst)	18.881	4.320	46.197	202.769	34.770	306.937
Stores (allocated on direct materials)	0.029	-	71.200	192.687	3.091	267.007
<u>GENERAL ADMIN</u>						
Directly identifiable items (customer postage)	-	-	-	-	246.307	246.307
Employers NI (spread on employment costs)	37.336	7.252	91.729	266.604	223.390	626.311
Other General Admin	90.307	12.714	295.564	1,102.690	544.529	2,045.804
Rounding				3.000		3.000
Total General & Support Costs	609.007	60.222	1,505.398	3,528.342	2,041.635	7,744.604
TOTAL OPERATING COSTS	2,370.4	382.2	2,376.1	8,249.8	4,019.3	17,397.8
OTHER BUSINESS ACTIVITIES	143	78	117	117	77	532
SCIENTIFIC SERVICES	157		381	495		1,033
DOUBTFUL DEBTS					810	810
GENERAL RATES	246	175	1,006	482	159	2,069
BULK SUPPLY	22					22
	2,938.6	634.8	3,879.7	9,344.3	5,066.1	21,863.4
<u>FUNCTIONAL EXPENDITURE</u>						
Third Party Costs (RCW)				844		844
Renewals Expensed				1,752		1,752
CC Depreciation	383	257	2,487	2,217	196	5,540
Depreciation Recharge				(168)	168	-
						-
	3,322	892	6,367	13,989	5,430	29,999

ACCOUNTING SEPARATION 2015/16

Appendix 2: Wholesale Allocation of Operating Costs by Business Unit

ACTIVITY COSTING ANALYSIS - WATER SERVICE						
DESCRIPTION	Units	Water resources	Raw water distribution	Water treatment	Treated water distribution	Water Service Total
SERVICE ANALYSIS - WATER						
Direct costs						
Employment costs	£m	0.010	0.005	0.377	2.137	2.529
Power	£m	0.387	0.317	0.233	1.036	1.973
Hired and contracted services	£m	0.003		0.004	0.615	0.622
Materials and consumables	£m			0.246	0.667	0.913
Service charges	£m	1.323				1.323
Other direct costs	£m	0.039		0.010	0.266	0.315
Total direct costs	£m	1.762	0.322	0.870	4.721	7.675
Operating expenditure						
General and support expenditure	£m	0.609	0.060	1.505	3.529	5.703
Scientific services	£m	0.157		0.381	0.495	1.033
Other business activities	£m	0.143	0.077	0.117	0.117	0.454
Total business activities	£m	0.300	0.077	0.498	0.612	1.487
Local Authority rates	£m	0.246	0.175	1.007	0.482	1.910
Total opex less third party services	£m	2.917	0.634	3.880	9.344	16.775
Bulk Supply	£m	0.022				0.022
Third party services - opex	£m		0.000	0.000	0.844	0.844
Total operating expenditure	£m	2.939	0.634	3.880	10.188	17.641
Capital maintenance						
Renewals Expensed	£m				1.752	1.752
Current cost depreciation	£m	0.383	0.257	2.487	2.217	5.344
Depreciation Recharge to Retail					-0.168	-0.168
Rounding	£m					0.000
Total capital maintenance	£m	0.383	0.257	2.487	3.801	6.928
Total operating costs	£m	3.322	0.891	6.367	13.989	24.569

Appendix 3: Retail Allocation of Operating Costs by Business Unit

ACTIVITY COSTING ANALYSIS - RETAIL SERVICES				
DESCRIPTION	Units	Retail household	Retail non-household	Retail Services Total
SERVICE ANALYSIS - RETAIL				
Direct costs				
Billing	£m	0.295	0.048	0.343
Payment handling, remittance and cash handling	£m	0.114	0.005	0.119
Debt management	£m	0.420	0.043	0.463
Doubtful debts	£m	0.803	0.007	0.810
Non network customer enquiries and complaints	£m	0.756	0.085	0.841
Meter reading	£m	0.089	0.019	0.108
Network customer enquiries and complaints	£m	0.224	0.025	0.249
Disconnections	£m		0.001	0.001
Demand side water efficiency initiatives	£m	0.112	0.003	0.115
Services to developers	£m		0.084	0.084
Customer side leaks	£m	0.147		0.147
Total direct costs	£m	2.960	0.320	3.280
Operating expenditure				
General and support expenditure	£m	1.407	0.142	1.549
Other business activities	£m	0.074	0.004	0.078
Total business activities	£m	0.074	0.004	0.078
Local Authority rates	£m	0.151	0.008	0.159
Exceptional items	£m			0.000
Total opex less third party services	£m	4.592	0.474	5.066
Third party services	£m			0.000
Total operating expenditure	£m	4.592	0.474	5.066
Capital maintenance				
Current cost depreciation	£m	0.186	0.010	0.196
Depreciation Recharge from Wholesale		0.159	0.009	0.168
Total capital maintenance	£m	0.345	0.019	0.364
Total operating costs	£m	4.937	0.493	5.430

Appendix 4: Allocation of Assets to Retail

2015/16

Table of Retail Fixed Assets

Assets Directly Coded to Retail	Total Value NBV	Retail NBV	Household NBV	Non-household NBV	Total Value Depreciation	Retail Depreciation	Household Depreciation	Non-household Depreciation	Cost Driver Household/Non-Household
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	
Billing System	446	446	422	24	120	120	114	6	No of Customers HH/Non-HH
Vehicles	20	20	19	1	22	22	21	1	No of Customers HH/Non-HH
Other Assets	39	39	37	2	54	54	51	3	No of Customers HH/Non-HH
TOTAL DIRECT RETAIL	505	505	478	27	196	196	186	10	
<u>Assets with a recharge to Retail</u>									
Telephony Equipment	58	25	24	1	24	11	10	1	
<u>Buildings -</u>									
Head Office (Main Building)	3,152	1,485	1,408	77	63	30	28	2	No of Customers HH/Non-HH
Other Buildings (Stores, Garage, Car Park at Havant, % to Retail)	1,482	427	405	22	41	8	7	1	No of Customers HH/Non-HH
Vehicles	141	29	27	2	42	8	8	-	No of Customers HH/Non-HH
<u>Land -</u>									
Head Office	854	162	154	8	-	-	-	-	No of Customers HH/Non-HH
Other Plant	2,268	759	720	39	350	107	101	6	No of Customers HH/Non-HH
Other Operational Assets	436	87	82	5	18	4	4	-	No of Customers HH/Non-HH
TOTAL RECHARGE	8,391	2,974	2,820	154	538	168	158	10	
TOTAL RETAIL ASSETS	8,896	3,479	3,298	181	734	364	344	20	