

## ACCOUNTING SEPARATION 2016/17

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For inclusion in Annual Performance Report Year ended 31<sup>st</sup> March 2017

### PORTSMOUTH WATER LTD METHODOLOGY STATEMENT 2016/17

#### Governance Process

The Accounting Separation analysis has been prepared by the Regulation 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 and the Supply Manager. 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 was using a mainframe accounting system up until October 2016, when a new ERP system (IFS) was implemented. 18 months of P&L and Balance Sheet account balances from the mainframe were uploaded to IFS. Accounting Separation requirements for the Annual Performance Report form a fundamental basis to the new coding structure of the new system.

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.

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.

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### **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 2015/16, and referred to below, were reviewed and remain unchanged for 2016/17. These are used mainly for the data originating from the mainframe (April 2016 – September 2016).

### **Direct Costs**

#### **Employment Costs Distribution**

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. In the new IFS system, all direct employees either complete a timesheet, or if they are a supervisor or manager they will have their costs allocated to the chargeout rates of their direct reports. Direct employees also 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 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, which are relatively small, are allocated to Retail on the basis of a management estimate. This is 30% and relates to the amount of time that staff spend doing Retail activities, and the rest is allocated to Treated Water Distribution.

In IFS Meter Readers (Assistant Inspectors) have their own department code, and this enables their salary and administration costs to be directly allocated to Retail.

The Leakage Inspectors and support staff also have their own department codes in IFS and are directly allocated to Treated Water Distribution.

#### **Distribution Administration**

These costs are allocated to either Treated Water Distribution or Retail. In IFS, management and supervisors have their costs added to the chargeout rates of their direct reports, so no management estimate is needed. However, for the first 6 months of the year this was not the case and some manual allocations have been used.

Water Regulations costs are allocated 100% to Treated Water Distribution. The remaining costs relate to office staff, of which 3 work for Retail (Network customer queries) and the rest for Wholesale. In IFS these staff do not complete timesheets and a manual allocation still needs to be done.

#### **Operations Centre**

Costs are allocated to all business units on the basis of the activities that the operations 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.

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### 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.

### Open Water Costs

Customer Services staff time costs, relating to Open Water, have been allocated to Wholesale. This is based on a management estimate.

### **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 at this site.

These pumping head figures were revised and updated in 2015/16 and have not changed for 2016/17.

### **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%	
<b>AVERAGE PUMPING HEAD</b>						<b>53.2%</b>	<b>42.0%</b>	<b>4.8%</b>	

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. This is the only raw water distribution at Portsmouth Water, which complies with the Ofwat definition.

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### **Employment Costs Supply**

Direct Costs booked to pumping stations are allocated between the business units on a management estimate, and this reflects the high proportion of time spent at the Treatment Works. 90% of time is allocated here. Previously, Supervisor costs were allocated to sites on the basis of a management estimate. However, in IFS direct labour is charged to specific assets via work orders and Supervisors have been added to the chargeout rate of their direct reports. This allows for a more accurate allocation of costs.

### **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 Distribution Administration and Operations Centre costs to be allocated to individual business units, and in particular between Wholesale and Retail. 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, a management estimate of time spent carrying out the activities of the different business units was used to enable 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 most of the areas below, due to the complexity of the work and general nature of many of the activities. The exceptions are Building Maintenance and Mechanical & Electrical activities, where timesheets are completed.

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 been identified and other associated costs not directly attributable have been allocated on the

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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, as this covers activity at every site.

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.

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 and Promotional Strategy 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.

Financial Services: Financial Services costs have been split on the basis of FTE's in each business unit, as per the issued table 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 2015/16 we allocated 2 computers/devices to all Customer services staff. However, on reflection, this did not accurately reflect the effort needed to service this function by IT. We have reduced the number down to one per desk, even though each member of staff has a payment device on their desk as well.

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.

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.

Pension Costs: These costs of this have been allocated directly to departments, in line with the IFS payroll system. However, the FRS17 pension cost has been allocated on the basis of salary costs in each business unit.

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National Insurance costs: These costs have been allocated directly to departments, in line with the IFS payroll system.

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, and the treatment 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.
- 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 have been allocated on the basis of 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.
- 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.

### 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.

### 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.

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### **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 to Treated Water Distribution.

### **Infrastructure Renewals Expenditure**

This has been allocated directly to Treated Water Distribution.

### **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 Debt Provision

Meter Reading

% of Inspectors (see Wholesale allocations)

% 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

Non-Household Operating Agreement (with Castle Water)

### **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

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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 consists 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 consists 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

Non-household Operating Agreement

**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.

**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.



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**Doubtful Debts:** Costs are allocated directly to this activity, and the allocation between household and non-household is a direct allocation.

For 2016/17 the total amount of Doubtful Debts is £785k. This is split as follows:

Unmeasured Doubtful Debts	£411k	> 99% household
Measured Doubtful Debts	£374k	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.

**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 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.

**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.

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**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.

**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 took 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.

### **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.

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Overall, Retail operating costs have increased by 3%, but there have been some large movements between categories, due partly to revised allocation methods.

	<u>Change 2017 vs 2016</u>
Customer Services	14%
Debt Management	-30%
Meter Reading	16%

Customer Services increased by 14% (£0.213m) due to the reallocation of staff from Debt Management. Some Debt Recovery staff now answer customer calls, as well as engaging in debt recovery (£0.137m). The rest of the increase is due to a more accurate allocation of time to Retail activities in the new system. In particular, there is an increase in customer query visits by Inspectors (£0.071m).

Debt Management decreased by 30% (-£0.137m) as some of these staff answer general customer non-network calls, as well as dealing with debt recovery issues. More costs have consequently been allocated to Customer Services.

Meter Reading costs increased by 16% (£17k). There have been more hours booked to meter reading by the assistant inspectors, due to additional meters from new properties and meter optants (£22k).

### **Current Cost Analysis of Fixed Assets (Wholesale and Retail)**

Portsmouth Water still keeps current cost fixed asset ledgers for all categories of fixed assets, even though this is no longer an Ofwat requirement. 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 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.

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. In addition, within Wholesale, assets which have Treated Water Distribution or Water Treatment as their principal use business unit have some recharges to Water Resources.

### **Historic Fixed Asset Ledgers**

New tables in the Annual Performance Report require direct Retail and Water Resources assets to be identified, and their associated depreciation. In addition, assets where there is a recharge from the principal use business unit to other business units e.g. 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.

The new IFS system now automatically reports assets by business unit, and all future additions will be assigned a primary business unit and recharge business units for depreciation.

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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.

### **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 31<sup>st</sup> 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.

#### **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.

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### 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.

### 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.

### **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.

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.

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:** 11.05.2017

## ACCOUNTING SEPARATION 2016/17

### Appendix 1: Allocation of Operating Costs to Business Units

#### ANNUAL PERFORMANCE REPORT - BUSINESS UNIT TABLES

2016/17

	Water Resources £000	Raw Water Distribution £000	Water Treatment £000	Treated Water Distribution £000	Retail £000	Total £000
<b>DIRECT COSTS</b>						
Employment Costs	14	10	581	2,562	402	3,571
Power (add climate change levy)	396	277	253	1,202	-	2,127
Hired & Contracted Services	6	-	25	822	97	949
Materials & Consumables	0	-	305	469	7	781
Service Charges	1,322	-	-	-	-	1,322
Other Direct Costs	63	-	10	271	1,518	1,862
<b>Total Direct Costs</b>	<b>1,801</b>	<b>287</b>	<b>1,174</b>	<b>5,326</b>	<b>2,024</b>	<b>10,612</b>
<b>GENERAL &amp; SUPPORT ACTIVITIES</b>						
Land & Property (direct and prorata)	32	32	74	100	16	254
Mechanical & Electrical (direct and prorata)	129	19	222	433	12	815
Supply Engineer (on M&E basis)	27	4	46	90	2	169
Supply General - Direct Allocation	8	1	14	27	1	50
Personnel Services (FTE's)	22	5	57	169	240	493
Legal & Property (FTE's)	12	3	32	96	68	211
Financial Services (FTE's)	46	10	120	356	253	785
Directors (Activity and Board Agenda)	65	14	85	253	221	638
IT (direct and no of devices)	49	13	200	471	323	1,056
Operational / Technical Support (GMEAV)	1	1	42	281	-	325
Vehicles & Plant (Closing NBV of assetst)	18	3	81	244	35	381
Stores (allocated on direct materials)	0	-	133	204	3	340
Investments not capitalised	14	2	200	161	-	377
<b>GENERAL ADMIN</b>						
Directly identifiable items (customer postage)	-	-	-	-	229	229
Other General Admin	35	6	94	603	283	1,020
Rounding	-	-	-	(4)	-	(4)
<b>Total General &amp; Support Costs</b>	<b>457</b>	<b>114</b>	<b>1,400</b>	<b>3,483</b>	<b>1,687</b>	<b>7,140</b>
<b>TOTAL OPERATING COSTS</b>	<b>2,257</b>	<b>401</b>	<b>2,573</b>	<b>8,810</b>	<b>3,711</b>	<b>17,752</b>
<b>OTHER BUSINESS ACTIVITIES</b>	<b>406</b>	<b>96</b>	<b>151</b>	<b>219</b>	<b>96</b>	<b>969</b>
<b>SCIENTIFIC SERVICES</b>	<b>183</b>	<b>-</b>	<b>360</b>	<b>468</b>	<b>-</b>	<b>1,012</b>
<b>DOUBTFUL DEBTS</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>785</b>	<b>785</b>
<b>GENERAL RATES</b>	<b>249</b>	<b>177</b>	<b>1,016</b>	<b>487</b>	<b>161</b>	<b>2,090</b>
<b>NHH RETAIL EXPENDITURE</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>522</b>	<b>522</b>
<b>BULK SUPPLY</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>18</b>	<b>-</b>	<b>18</b>
	<b>3,095</b>	<b>674</b>	<b>4,101</b>	<b>10,002</b>	<b>5,275</b>	<b>23,148</b>
<b>FUNCTIONAL EXPENDITURE</b>						
Third Party Costs (RCW)	-	-	-	546	-	546
Renewals Expensed	-	-	-	4,212	-	4,212
	3,095	674	4,101	14,760	5,275	27,906
CC Depreciation	358	311	2,932	2,510	96	6,207
Depreciation Recharge	61	-	(9)	(282)	230	-
	-	-	-	-	-	-
<b>TOTAL COSTS</b>	<b>3,514</b>	<b>985</b>	<b>7,024</b>	<b>16,988</b>	<b>5,601</b>	<b>34,113</b>

## ACCOUNTING SEPARATION 2016/17

### 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
<b>SERVICE ANALYSIS - WATER</b>						
<b>Direct costs</b>						
Employment costs	£m	0.014	0.010	0.581	2.562	3.167
Power	£m	0.396	0.277	0.253	1.202	2.128
Hired and contracted services	£m	0.006		0.025	0.822	0.853
Materials and consumables	£m			0.305	0.469	0.774
Service charges	£m	1.322				1.322
Other direct costs	£m	0.063		0.010	0.271	0.344
Total direct costs	£m	1.801	0.287	1.174	5.326	8.588
<b>Operating expenditure</b>						
General and support expenditure	£m	0.443	0.112	1.200	3.699	5.454
Scientific services	£m	0.183		0.360	0.469	1.012
Other business activities	£m	0.406	0.096	0.151	0.219	0.872
Total business activities	£m	0.589	0.096	0.511	0.688	1.884
Local Authority rates	£m	0.249	0.177	1.016	0.487	1.929
Total opex less third party services	£m	3.082	0.672	3.901	10.200	17.855
Bulk Supply	£m			0.018		0.018
Third party services - opex	£m				0.546	0.546
Total operating expenditure	£m	3.082	0.672	3.919	10.746	18.419
<b>Capital maintenance</b>						
Renewals Expensed	£m				4.212	4.212
Historic cost depreciation	£m	0.228	0.116	1.775	2.989	5.108
Historic costs amortisation	£m				0.367	0.367
Depreciation Recharge to Retail	£m	0.038		-0.009	-0.265	-0.236
Rounding	£m					0.000
Total capital maintenance	£m	0.266	0.116	1.766	7.303	9.451
Total operating costs	£m	3.348	0.788	5.685	18.049	27.870

### 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
<b>SERVICE ANALYSIS - RETAIL</b>				
<b>Direct costs</b>				
Billing	£m	0.308	0.050	0.358
Payment handling, remittance and cash handling	£m	0.116	0.002	0.118
Debt management	£m	0.282	0.044	0.326
Doubtful debts	£m	0.428	0.357	0.785
Non network customer enquiries and complaints	£m	0.884	0.068	0.952
Meter reading	£m	0.104	0.021	0.125
Network customer enquiries and complaints	£m	0.310	0.028	0.338
Disconnections	£m		0.000	0.000
Demand side water efficiency initiatives	£m	0.117	0.004	0.121
Services to developers	£m		0.080	0.080
Customer side leaks	£m	0.104		0.104
Total direct costs	£m	2.653	0.654	3.307
<b>Operating expenditure</b>				
General and support expenditure	£m	1.128	0.583	1.711
Other business activities	£m	0.092	0.004	0.096
Total business activities	£m	0.092	0.004	0.096
Local Authority rates	£m	0.153	0.008	0.161
Exceptional items	£m			0.000
Total opex less third party services	£m	4.026	1.249	5.275
Third party services	£m			0.000
Total operating expenditure	£m	4.026	1.249	5.275
<b>Capital maintenance</b>				
Historic Cost Depreciation	£m	0.113	0.006	0.119
Depreciation Recharge from Wholesale	£m	0.224	0.012	0.236
Total capital maintenance	£m	0.337	0.018	0.355
Total operating costs	£m	4.363	1.267	5.630

## **Appendix 4: Upstream Services (Wholesale Business)**

### **Governance Process**

The Upstream Accounting Separation in table 4D has been prepared by the Management Accountant and reviewed by the Financial Controller as part of the Annual Performance Report process. The allocation of operating expenditure between Trunk and Local Treated Water Distribution Business Units is no longer required.

The Regulation Manager has reviewed the methodology which was approved by the Engineering Director in 2012/13, and approved the data for submission to Ofwat.

### **Methodology Statement for Accounting Separation**

This guidance details the methods used to allocate the total operating costs from the existing split of Wholesale Business Units, to the lower level split of Services, as follows:

<u>Water Resources</u>	Abstraction Licence Raw Water Abstraction
<u>Raw Water Distribution</u>	Raw Water Transport Raw Water Storage
<u>Water Treatment</u>	No further split
<u>Treated Water Distribution</u>	No further split

### **Operating Expenditure**

#### **Water Resources**

The Abstraction Licence costs are taken from the invoice paid to the Environment Agency, relating to 2015/16. The remaining expenditure is all Raw Water Abstraction, including power, labour and an allocation of overheads.

#### **Raw Water Distribution**

Raw Water Storage relates to Highwood Reservoir at the Itchen site.

The costs allocated include power and associated direct employment costs. The remaining expenditure is all Raw Water Transport.

### **Capital Expenditure**

#### **Water Resources**

All the capital expenditure is allocated to Raw Water Abstraction.

#### **Raw Water Distribution**

Capital Expenditure for Highwood Reservoir would be allocated to Raw Water Storage, however this is zero for the year, and all other expenditure is allocated to Raw Water Transport.

### **Volumes for unit cost information**

Portsmouth Water collates volume and other operational data as part of the year end reporting process. This data is audited by WS Atkins for inclusion in year end reports.

For the only Raw Water Storage facility, Highwood Reservoir, there is capacity for 4 days storage.