

Accounting Separation Methodology Statement: 2024-25

1. Introduction

The purpose of this statement is to explain the systems and processes used to populate tables in the Annual Performance Report (APR). We explain the methodology used in the allocation of revenue and expenditure between price controls, customer types and upstream services.

The APR can be found on our website at www.portsmouthwater.co.uk/strategies-policies/accounts/

Our detailed management information reports allow costs to be identified for each cost centre, and therefore the Direct Costs of each business unit (e.g. Water Resources) can be built up using these reports. The management reports also 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. It is therefore necessary to use methods of allocation to be able to provide this level of detail.

Accounting Separation requirements for the Annual Performance Report form a fundamental basis to the coding structure of the finance system (IFS).

Ofwat's Guideline for Classification of Costs Across the Price Controls (RAG 2.09) has been followed, to separate all costs for the reporting of figures in the segmental Wholesale and Retail tables of the APR. 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 our management information reports. Some indirect costs are capable of being charged directly to business units; however, with some indirect costs centres it is necessary to allocate costs between business units, using an appropriate cost driver. (e.g. direct material costs for the allocation of Stores costs).

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

We have allocated a small number of costs on a management estimate basis. Where we have chosen to do so, we are satisfied that this was the only valid option at this time.

Appendix 1 provides a summary of the cost allocation by business unit. Appendix 2 and Appendix 3 provide Wholesale and Retail cost summaries.

1.1. Governance Process

The Accounting Separation analysis has been prepared by the Regulatory Finance Manager and reviewed by the Head of Economic Regulation. The allocation of direct costs between Wholesale and Retail has been reviewed and agreed by senior operational management.

The Chief Financial Officer is accountable for Accounting Separation allocations and has approved the data for inclusion in the Annual Performance Report (APR).

2. Wholesale Operating Cost Analysis

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

The allocation bases below are considered the most appropriate treatment for each of the cost areas. We have taken consideration of the cost, time and appropriateness of other allocation methods and has decided that the above treatments are the most appropriate for us to apply. The treatment of direct costs and operating expenditure is consistent with the treatment of the relevant fixed assets for allocation purposes. Management estimate percentages used, and referred to below, were reviewed and updated for 2024-25.

2.1 Direct Costs

2.1.1 Employment Costs

2.1.1.1 Distribution

The costs 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 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 charge-out rates of their direct reports. Direct employees also book time to specific assets, which allows for more accurate allocation of this cost.

2.1.1.2 Production Operations

Direct employment costs coded to cost centres for Production have been directly allocated to Wholesale. Direct Costs booked to pumping stations, by Production Operations staff, are allocated between the business units on a management estimate, and this reflects the high proportion of time spent at the Treatment Works. Ninety percent of time is allocated here. Direct labour is charged to specific assets via work orders and supervisors have been added to the charge-out rate of their direct reports.

Employment costs relating to the Farlington and Itchen water treatment sites are allocated directly to Water Treatment.

2.1.1.3 Network Operations

Some Network department have costs which are split between Wholesale and Retail functions as follows:

Network Technicians

These costs are allocated to either Treated Water Distribution or Retail. Costs of debt recovery/disconnections consultations, query/complaint investigations (which turn out to be on the customer side of the network) and customer-side leaks are directly allocated by timesheets to Retail. All other direct costs, allocated by timesheets, relate to Treated Water Distribution.

Meter Readers

These employees have their own cost centre code, and this enables their salary and administration costs to be directly allocated to Retail.

Leakage Technicians

The technicians and support staff also have their own department codes and are directly allocated to Treated Water Distribution.

Network Administration

These costs are allocated to either Treated Water Distribution or Retail. In IFS, management and supervisors have their costs added to the charge-out rates of their direct reports, so no management estimate is needed.

Water Regulations

These costs are allocated 100% to Treated Water Distribution.

Network Maintenance

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

The remaining costs relate to office staff, three of whom perform Retail activities (Network customer queries) and the rest Wholesale activities (scheduling and support). These staff are not directly charged to specific areas, and a manual allocation is required.

2.1.2 Power

Power costs reported here mainly relate to treatment works and pumping stations, including borehole sites, and are 100% Wholesale. Power has been allocated based on the specific asset's consumption. Each individual location is invoiced and coded separately, and bills provide the data for consumption and cost by location. Each of these costs is reported by location.

Where a pump asset consumes power for a dual purpose, a split based on pumping head has been used to allocate the cost between functions. These functions are mainly Water Resources 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 and from the Itchen water treatment site. 100% of power costs have been allocated to the Bulk Supply at Slindon in 2024-25 and 25% of the power costs at the Itchen.

These pumping head figures were revised and updated for 2024-25.

Pumping Head Allocation

| | Pumping Head | | | | | Water Resources % | Raw Water Transport % | Treatment Works % | Distribution % | Bulk Supply % |
|-----------------------------------|-----------------|---------------------|-----------------|--------------|---------------|----------------------|-----------------------|---------------------|----------------------|---------------|
| | Water Resources | Raw Water Transport | Treatment Works | Distribution | Total | | | | | |
| Eastergate | 12.97 | | | 37.74 | 50.71 | 26% | | 0% | 74% | 0% |
| Slindon | 47.44 | | | 17.04 | 64.48 | 74% | | 0% | 26% | 100% |
| Westergate | 13.47 | | | 32.41 | 45.88 | 29% | | 0% | 71% | 0% |
| Brickkiln | 21.75 | | | 15.14 | 36.89 | 59% | | 0% | 41% | 0% |
| Fishbourne | 7.44 | | | 73.23 | 80.67 | 9% | | 0% | 91% | 0% |
| Lavant | 9.95 | | | 37.07 | 47.02 | 21% | | 0% | 79% | 0% |
| Funtington | 13.57 | | | 43.51 | 57.08 | 24% | | 0% | 76% | 0% |
| Walderton | 8.92 | | | 34.25 | 43.17 | 21% | | 0% | 79% | 0% |
| Lovedean | 44.67 | | 23.11 | 63.46 | 131.24 | 34% | | 18% | 48% | 0% |
| Worlds End | 36.31 | | | 52.22 | 88.53 | 41% | | 0% | 59% | 0% |
| Woodmancote | 0.00 | | | 0.00 | 0.00 | 0% | | 0% | 0% | 0% |
| West Meon | 0.00 | | | 0.00 | 0.00 | 0% | | 0% | 0% | 0% |
| Northbrook | 31.36 | | | 30.83 | 62.19 | 50% | | 0% | 50% | 0% |
| West Street | 11.14 | | | 19.41 | 30.55 | 36% | | 0% | 64% | 0% |
| Maindell | 0.00 | | | 0.00 | 0.00 | 0% | | 0% | 0% | 0% |
| Soberton | 18.93 | | | 20.56 | 39.49 | 48% | | 0% | 52% | 0% |
| Havant | 50.08 | | | | 50.08 | 100% | | 0% | 0% | 0% |
| Bedhampton | 45.68 | | | | 45.68 | 100% | | 0% | 0% | 0% |
| Aldingbourne | 17.17 | | | 46.91 | 64.08 | 27% | | 0% | 73% | 0% |
| Newtown | 40.00 | | | | 40.00 | 100% | | 0% | 0% | 0% |
| Lower Upham | 0.00 | | | | 0.00 | 0% | | 0% | 0% | 0% |
| Hampshire Bulk Supply from Itchen | | | | | | | | | 75% | 25% |
| AVERAGE PUMPING HEAD | | | | | 63.61 100% | 27.91 44% | - 0% | 6.50 10% | 29.20 46% | |

Pumping costs from Havant and Bedhampton Springs to Farlington Treatment Works were previously classed as Raw Water Distribution. However, following discussions with Ofwat, this is now considered to be part of the Water Resources process. We do not now have any raw water transport, only raw water storage at Highwood Reservoir.

There is also an allocation of power costs at Itchen, based on pumping head, between Water Resources and Treated Water Distribution. This is our only river abstraction site and is the source of a bulk supply since 2019-20.

2.1.3 Hired and Contracted Services

As per the Ofwat guidance these costs have been allocated directly where possible and based on pumping head for costs relating to pumping stations.

2.1.4 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 for Network Administration and Operations Centre costs to be allocated to individual business units, and in particular between Wholesale and Retail.

Meter reading is a Retail function, and 100% of materials costs relating to this have been allocated to Retail.

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

2.1.5 Service Charges

Abstraction charges are included here and are allocated directly to Water Resources.

2.1.6 Other Direct costs

These are 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 Network Administration costs to be allocated to individual business units.

2.2 General and Support Expenditure

This covers the other areas of the business that do not directly deliver services to customers and includes a range of costs that have each been identified and allocated in several ways.

The only areas that directly attribute exceptions are Building & Grounds Maintenance and Mechanical & Electrical activities.

2.2.1 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. For Head Office costs these have been allocated based on the floor space occupied by the different functions at the Head Office.

2.2.2 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 where a production site is mixed use allocated based on pumping head. Other associated costs not directly attributable have been allocated on a pro rata basis of those directly allocated. No costs have been allocated to Retail.

2.2.3 Production Engineer

These represent the cost of the Production 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.

2.2.4 People

People department costs have been split based on Full Time Equivalents (FTEs) in each business unit, as per the Ofwat guidance. These costs include Staff Welfare. However, any costs relating to Water Efficiency and Promotional Strategy have been directly allocated to Retail.

2.2.5 Company Secretary

These costs have been split based on FTEs in each business unit, as per the Ofwat guidance.

2.2.6 Financial Services

Financial Services costs have been split based on FTEs in each business unit, as per the Ofwat guidance.

2.2.7 Information Technology

The allocation of IT costs is based on the number of computers and mobile devices in each Business Unit.

2.2.7 Operational & Technical support

Allocation of costs by business unit is based on the Gross Minimum Equivalent Asset Value (GMEAV) of assets additions in the year for Asset Planning and to Treated Water Distribution for the Digital Services team.

2.2.8 Vehicles & Plant

These costs have been allocated based on number of vehicles as per Ofwat guidance. Motor vehicle insurance is included in these costs. (The motor fleet is insured through one premium with no vehicles being listed separately.)

2.2.9 Materials Storage

These costs have been split based on the allocation of direct costs of materials and consumables as per Ofwat guidance.

2.2.10 Pension Costs

The employer contribution costs of this have been allocated directly to departments, in line with the IFS payroll system.

3.2.11 National Insurance costs

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

2.3 General Administration

The remaining General Administration costs have been allocated directly to an individual business unit where possible. However, there are some costs that cannot be allocated directly, and the treatment of these are as follows:

- Head Office utilities and costs - these have been split based on floor area by business unit.

- Directors' salaries and related costs - allocation for the Executive Directors is based on a management estimate of time spent on activities, including an analysis of the Board agendas during the year. Allocation for the Non-Executive Directors is based on the Board agenda analysis only.
- General materials - allocated based on the direct allocation of Materials & Consumables.
- Insurance costs – the allocation of insurance costs is direct to a business unit where possible and based on FTEs 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 other printed documents. These costs have then been further allocated on the basis of FTEs. Seventy percent of the costs have been allocated to Retail and relate mainly to customer billing and debt management.

2.3.1 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.

2.3.2 Other Business Activities

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

However, with only Highwood Reservoir in Raw Water Distribution, only 1% of the costs have been allocated here.

2.3.3 Local Authority Rates

The costs of local authority rates are split on floor space as per the Ofwat guidance. This includes the Head Office site, Farlington and Itchen treatment works, pumping stations and booster stations.

2.3.4 Third-Party Services Opex

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

3. Infrastructure Renewals Expenditure

This has been allocated directly to Treated Water Distribution.

4. Historic Cost Depreciation

This allocation comes directly from the IFS fixed asset data.

5. Significant movements in Wholesale costs

Direct Costs reduced by £0.81m in Direct Costs from 2023-24, due to a number of factors:

- Electricity has decreased by £0.79m, due to unit prices being lower than in the prior year.
- Contractor services have decreased by £0.59m. This is due to lower costs in Treated Water Distribution.
- Employment Costs have increased by £0.59m due to staff required to maintain our performance in Treated Water Distribution.
- The remaining costs have been level with £0.26m additional abstraction costs offset by lower material and other costs.

General & Support costs are £0.23m higher, mainly due to an increase in costs in Mechanical & Electrical costs.

6. Significant movements in cost allocations

There were no significant changes to cost allocations in the year.

7. Retail Operating Cost Analysis

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

- Customer Services Department (including Debt Recovery and Postage)
- Print Room (70% of costs are direct Retail)
- Bad Debt Provision
- Meter Reading
- Allocation of Network Technicians (see Wholesale allocations)
- Allocation of Network Administration (see Wholesale allocations)
- Allocation of Operations Centre (see Wholesale allocations)
- Customer-side leaks
- Allocation of Other Business Activities (Regulation)
- Allocation of Head Office costs (Land, Property and Mechanical & Electrical)
- Allocation of General & Support costs

7.1 Direct Costs

The methodology for Retail is the same as for the Wholesale business. It identifies the direct costs of Employment, Materials & Consumables and other Direct Costs which have been allocated between Wholesale and Retail. These relate to the costs of Technicians, Meter Reading, Network 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 nominal ledger. These are as follows:

- Customer Services Department (including Debt Recovery and Postage)
- Bad Debt Provision

Below we describe how the direct costs have been allocated to the Retail activities. These are all Household Retail costs, as we exited the Non-Household Retail market from 2017-18. In addition, the costs within Household Retail are allocated between Measured and Unmeasured customers.

We are 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, we have used management judgement to produce the most appropriate methods of cost allocation in order to give accurate cost allocations.

In the APR, 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 4.09.

7.1.1 Customer Services

This consists of the following activities:

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

7.1.2 Other Operating Expenditure

This 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

7.1.3 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 based on number of bills sent. Thirty-three percent of General Management costs are allocated here.

An allocation of stationery is made from the Print Room, as well as 25% of the software licence costs.

These costs are all Household are allocated between Measured and Unmeasured customers based on number of bills raised, as per the guidance.

7.1.4 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 and maintenance is allocated here, along with 25% of the software licence costs.

These costs are all Household are allocated between Measured and Unmeasured customers based on number of bills raised, as per the guidance.

7.1.5 Debt Management

Employment Costs of 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.

Twenty-five percent of the software licence costs have been allocated here, as well as 33% of Management salaries.

The allocation of these Household costs between Measured and Unmeasured customers is based on the debt outstanding >30 days for each, at the end of March 2025.

7.1.6 Doubtful Debts

Costs are allocated directly to this activity, and all relate to Household customers.

For 2024-25 the total amount of Doubtful Debts is £696k. This consists of any debt write-offs and the movement in the bad debt provision. It is split as follows:

- Customer Unmeasured and measured: £696k
- Void Debt Provision: £0k

The Measured Doubtful Debts provision amount is calculated separately from Unmeasured, and reflects the risk associated with the current outstanding debt. The remainder of the calculation relates to an allowance for the movement in total debt written off, which can also be directly allocated to Measured and Unmeasured customers.

7.1.7 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, 25% of the software licence costs and a proportion of telephone costs from General & Administration.

The allocation between Household Measured and Unmeasured customers is based on the number of non-network customer contacts recorded for each business unit, as per the Ofwat guidance.

7.1.8 Meter Reading

Direct employment costs of Meter Readers are allocated to this activity, as detailed in the Wholesale commentary above, including meter reading supervision.

Associated transport costs are also allocated here. All costs are allocated to measured customers.

7.1.9 Network Customer Enquiries and Complaints

Direct employment costs of Network Technicians, Network Administration and the Operations Centre are allocated to this activity as well as other associated direct costs.

The allocation between Household Measured and Unmeasured customers is based on the number of network customer contacts recorded for each business unit, as per the Ofwat guidance.

7.1.10 Demand Side Water Efficiency Initiatives

These costs are directly identifiable and allocated to this Retail activity. The costs include water efficiency and promotional strategy.

These Household costs are allocated to Measured and Unmeasured customer is based on the number of customers in each category.

7.1.11 Services to Developers

These costs are the salaries of staff who deal directly with developers and the associated supervisory costs.

7.1.12 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 based on the number of customers in each category.

7.2 General and Support expenditure

These costs represent the remaining costs not identified as being direct. Their allocation between the Wholesale and Retail business units is described above.

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

7.3 Scientific Services

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

7.4 Other Business Activities

The costs of Regulation have been split evenly across all five business units, as per the Ofwat guidance. We only have one small storage reservoir in Raw Water Distribution, 24% of cost is allocated to Retail Household and 1% to Raw Water Distribution.

7.5 Local Authority Rates

The costs of local authority rates are split on floor space as per the Ofwat guidance. This includes the Head Office site, Farlington and Itchen treatment works, pumping stations and booster stations.

7.6 Third-Party Services

There are no identified Third-Party Services for Retail.

7.7 Historic Cost Depreciation

This allocation comes directly from the detailed fixed asset ledgers in IFS.

8. Significant movements in Retail Costs

As required by the Ofwat guidance, below we provide a summary of the Retail costs which have changed by greater than 10% since last year, and an explanation of the differences.

Overall, Retail operating expenditure has increased by 30% (£1.6m), with the movement by categories as shown below:

| Cost category | Change from 2023-24 |
|-----------------------|---------------------|
| Customer Services | +46% |
| Debt Management | +37% |
| Doubtful Debts | +39% |
| Local authority rates | +100% |

Customer Services costs have increased by 46% (£1.2m) due to an increase in staff and software costs. This is driven by the move from our old RAPID Customer Relations Management (CRM) system to the Kraken CRM system.

Debt Management charges have increased by 37% (£0.1m) due to additional software costs associated with the Kraken CRM system.

The Doubtful Debts provision has increased by 39% (£0.2m) due lower collection of outstanding debt.

Local authority rates have returned to the expected level of £0.1m; the large variation is due to a rates rebate in 2023-24 relating to prior years' charges, which were re-calculated by the Valuation Office.

9. Historic Cost Fixed Asset Ledgers

Tables in the APR require direct Retail and Water Resources assets to be identified, along with 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 Treated Water Distribution (the Principal Use Business Unit) need to be identified.

The IFS system automatically reports assets by business unit and all future additions are assigned to a primary business unit and recharge other business units for depreciation.

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

10. Asset Allocations between Business Units

10.1 Infrastructure Assets

Infrastructure Assets have been allocated directly to Treated Water Distribution or Water Resources. The assets at 31 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 our 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.

10.2 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.

10.3 Other Tangible Assets, Small Plant & Meters

The Small Plant Fixed Asset ledger has been analysed and those plant items that were directly identifiable as being used for only one business unit have been allocated directly to that business unit.

There are a number of small plant asset types that related to departments whose activities straddle the business units. These assets have been allocated on the same basis as the related operating costs.

10.4 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 Ofwat guidance.

10.5 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 used by the same department. The Head Office has been allocated based on 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. All other offices and depots have been allocated either directly or based on management estimates (as above).

10.6 Land

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

Where land is used for the purposes of more than one business unit, the land has been allocated accordingly. Technical drawings of the sites have been provided by our Digital Services team, and these have been used to allocate the land to each business unit necessary based on floor area.

10.7 Service Reservoirs and Treatment Works

These assets have been allocated directly to individual business units.

10.8 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 Production Manager. There are only a small number of assets that required allocation to more than one business unit.

10.9 Telemetry Assets

These have been allocated to a number of business units based on a management estimate.

11. Capitalisation Policy

We classify costs as either capital expenditure or operating expenditure based on a number of factors. These include the value, nature, and purpose of the expenditure. We have a Capitalisation Policy that gives details of the criteria used to classify costs across all departments.

A detailed capital programme is drawn up each October for the coming financial year. This is approved by the Board and incorporated into the 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 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. 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 Board. Purchases made are reviewed to ensure that these are all capital items. Our policy is that only items above £500 are capitalised.

This process is audited twice a year as part of our statutory audit. 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 CFO is accountable for ensuring that our capitalisation policies and procedures are being operated correctly and that they are fit for purpose. The CFO and Financial Controller ensure that we comply with the current applicable accounting standards.

Appendix 1: Allocation of Operating Costs to Business Units

ANNUAL PERFORMANCE REPORT - BUSINESS UNIT TABLES

2024/25

| | WATER RESOURCES | NETWORK + | | | RETAIL (Household) | Total |
|--|--------------------|-----------------------------------|----------------------------|--|-----------------------|---------------|
| | £000 | Raw Water Distribution £000 | Water Treatment £000 | Treated Water Distribution £000 | £000 | |
| <u>DIRECT COSTS</u> | | | | | | |
| Employment Costs | - | - | 322 | 3,818 | 3,592 | 7,732 |
| Power (includes climate change levy) | 1,915 | 1 | 522 | 2,200 | - | 4,638 |
| Hired & Contracted Services | - | - | 262 | 2,567 | 41 | 2,870 |
| Materials & Consumables | - | - | 265 | 683 | 37 | 985 |
| Service Charges | 1,767 | - | - | - | - | 1,767 |
| Other Direct Costs | - | - | 160 | 1,013 | 580 | 1,753 |
| Total Direct Costs | 3,682 | 1 | 1,530 | 10,281 | 4,249 | 19,743 |
| <u>GENERAL & SUPPORT ACTIVITIES</u> | | | | | | |
| Land & Property | 30 | 0 | 163 | 129 | 93 | 416 |
| Mechanical & Electrical | 652 | - | 239 | 875 | - | 1,766 |
| Supply Engineer | 101 | - | 37 | 135 | - | 273 |
| People | 73 | 0 | 192 | 377 | 231 | 873 |
| Legal & Property | 26 | 0 | 68 | 134 | 82 | 311 |
| Finance | 112 | 1 | 292 | 575 | 352 | 1,332 |
| IT | 140 | 0 | 356 | 629 | 422 | 1,547 |
| Operational / Technical Support | 3 | 0 | 8 | 38 | 0 | 49 |
| Vehicles & Plant | 44 | 0 | 176 | 388 | 90 | 698 |
| Stores | - | - | 132 | 124 | - | 256 |
| Directors | 90 | 2 | 99 | 229 | 108 | 526 |
| Investments not capitalised | 10 | 1 | 34 | 157 | 1 | 203 |
| GENERAL ADMIN | 149 | 1 | 329 | 8 | - | 468 |
| OTHER BUSINESS ACTIVITIES | 484 | 9 | 215 | 443 | 264 | 1,416 |
| SCIENTIFIC SERVICES | 518 | - | 792 | 1,030 | | 2,340 |
| DOUBTFUL DEBTS | | | | | 696 | 696 |
| GENERAL RATES | 308 | 2 | 721 | 392 | 106 | 1,529 |
| BULK SUPPLY | | | | 415 | | 415 |
| TOTAL OPERATING COSTS | 6,422 | 16 | 5,383 | 16,360 | 6,677 | 34,858 |
| Enhancement Opex | 42 | | | | | 1,529 |
| <u>FUNCTIONAL EXPENDITURE</u> | | | | | | |
| Third Party Costs (RCW) | | | | 677 | | 677 |
| Renewals Expensed | | | | 140 | | 140 |
| | 6,465 | 16 | 5,383 | 17,176 | 6,677 | 35,716 |
| Exceptional pension costs | 28 | 0 | 74 | 146 | 89 | 337 |
| TOTAL | 6,493 | 16 | 5,457 | 18,138 | 6,766 | 36,870 |

Appendix 2: Wholesale Allocation of Operating Costs by Business Unit

| ACTIVITY COSTING ANALYSIS - WATER SERVICE | | | | | | |
|---|-------|-----------------|----------------|---------------------|---------------------|----------|
| DESCRIPTION | Units | 2024-25 | | | 2023-24 | Variance |
| | | Water resources | Water Network+ | Water Service Total | Water Service Total | |
| SERVICE ANALYSIS - WATER | | | | | | |
| Direct costs | | | | | | |
| Employment costs | £m | 0.00 | 4.14 | 4.14 | 3.55 | 0.59 |
| Power | £m | 1.92 | 2.72 | 4.64 | 5.56 | -0.93 |
| Hired and contracted services | £m | 0.00 | 2.83 | 2.83 | 3.42 | -0.59 |
| Materials and consumables | £m | 0.00 | 0.95 | 0.95 | 1.61 | -0.66 |
| Service charges | £m | 1.77 | 0.00 | 1.77 | 1.51 | 0.26 |
| Other direct costs | £m | 0.00 | 1.17 | 1.17 | 0.79 | 0.38 |
| Total direct costs | £m | 3.68 | 11.81 | 15.50 | 16.44 | -0.94 |
| Operating expenditure | | | | | | |
| General and support expenditure | £m | 1.46 | 6.15 | 7.61 | 7.19 | 0.42 |
| Scientific services | £m | 0.52 | 1.82 | 2.34 | 2.15 | 0.19 |
| Other business activities | £m | 0.48 | 0.67 | 1.15 | 1.43 | -0.28 |
| Total business activities | £m | 1.00 | 2.49 | 3.49 | 3.58 | -0.09 |
| Local Authority rates | £m | 0.31 | 1.12 | 1.42 | -0.13 | 1.56 |
| Total opex less third party services | £m | 6.45 | 21.56 | 28.02 | 27.07 | 0.94 |
| Bulk Supply | £m | | 0.42 | 0.42 | 0.27 | 0.15 |
| Third party services - opex | £m | | 0.68 | 0.68 | 0.60 | 0.08 |
| Operating cost recharge | £m | 0.02 | -0.18 | -0.16 | -0.16 | 0.00 |
| Total operating expenditure | £m | 6.47 | 22.48 | 28.95 | 27.78 | 1.17 |
| Capital maintenance | | | | | | |
| Renewals Expensed | £m | | 0.14 | 0.14 | 0.10 | 0.05 |
| Historic cost depreciation | £m | 0.23 | 6.19 | 6.42 | 6.20 | 0.22 |
| Historic costs amortisation | £m | | 0.46 | 0.46 | 0.12 | 0.34 |
| Depreciation Recharge to Retail | £m | | -0.04 | -0.04 | -0.04 | 0.00 |
| Rounding | £m | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total capital maintenance | £m | 0.23 | 6.75 | 6.98 | 6.38 | 0.60 |
| Total costs | £m | 6.70 | 29.23 | 35.93 | 34.16 | 1.77 |

Appendix 3: Retail Allocation of Operating Costs by Business Unit

ACTIVITY COSTING ANALYSIS - RETAIL SERVICES

| DESCRIPTION | Units | Retail household | | |
|--|-------|------------------|---------|----------|
| | | 2024-25 | 2023-24 | Variance |
| SERVICE ANALYSIS - RETAIL | | | | |
| | | | | |
| Direct costs | | | | |
| Billing | £m | 0.86 | 0.69 | 0.17 |
| Payment handling, remittance and cash handling | £m | 0.21 | 0.12 | 0.09 |
| Debt management | £m | 0.41 | 0.30 | 0.11 |
| Doubtful debts | £m | 0.70 | 0.50 | 0.20 |
| Non network customer enquiries and complaints | £m | 2.10 | 1.21 | 0.89 |
| Meter reading | £m | 0.18 | 0.22 | -0.04 |
| Network customer enquiries and complaints | £m | 0.46 | 0.46 | 0.01 |
| Demand side water efficiency initiatives | £m | 0.00 | 0.07 | -0.07 |
| Customer side leaks | £m | 0.03 | 0.08 | -0.04 |
| Total direct costs | £m | 4.95 | 3.64 | 1.30 |
| | | | | |
| Operating expenditure | | | | |
| General and support expenditure | £m | 1.45 | 1.35 | 0.10 |
| Other business activities | £m | 0.26 | 0.18 | 0.08 |
| Total business activities | £m | 0.26 | 0.18 | 0.08 |
| Local Authority rates | £m | 0.11 | -0.01 | 0.12 |
| Total opex less third party services | £m | 6.76 | 5.17 | 1.60 |
| Third party services | £m | | | 0.00 |
| Operating cost recharges | £m | 0.16 | 0.16 | 0.00 |
| Total operating expenditure | £m | 6.92 | 5.32 | 1.60 |
| | | | | |
| Capital maintenance | | | | |
| Historic Cost Depreciation | £m | 0.00 | 0.00 | 0.00 |
| Depreciation Recharge from Wholesale | | 0.04 | 0.04 | 0.00 |
| Total capital maintenance | £m | 0.04 | 0.04 | 0.00 |
| Total operating costs | £m | 6.96 | 5.37 | 1.60 |

Appendix 4: Upstream Services (Wholesale Business)

Ofwat's 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 shown below.

| Business Unit | Service category |
|----------------------------|-----------------------|
| Water Resources | Abstraction Licence |
| | Raw Water Abstraction |
| Raw Water Distribution | Raw Water Transport |
| | Raw Water Storage |
| Water Treatment | No further split |
| Treated Water Distribution | No further split |

Operating Expenditure

Water Resources

The Abstraction Licence costs are taken from the invoice paid to the Environment Agency, relating to 2024-25. 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 River Itchen site. The costs allocated include power and associated direct employment costs.

We no longer have any Raw Water Transport costs. The costs associated with the transport of water from Havant and Bedhampton Springs to our Farlington Treatment Works is now classified as Water Resources, as agreed with Ofwat.

Capital Expenditure

Water Resources

All capital expenditure is allocated to Raw Water Abstraction.

Raw Water Distribution

Capital Expenditure for Highwood Reservoir is allocated to Raw Water Storage.