

Hafren Dyfrdwy Cyfyngedig

Accounting Separation Methodology Statement

Year ended 31 March 2021

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Hafren Dyfrdwy Accounting Separation Methodology Statement

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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 Annual Performance Report tables can be found on our website (www.hdcymru.co.uk).

1. Business structure, systems and sources of information used to populate tables

The operating business structure at Hafren Dyfrdwy ('HD') is as follows:



* General and support services provided by Severn Trent Water, recharged via the intercompany process.

** Direct general and support services and recharged services.

Systems in place

Information used to populate the tables originates from our SAP system which is interfaced with Tagetik (consolidation) and Business Warehouse ('BW') systems. Financial reports are retrieved from these systems to produce the APR.

Information providers

Information in the APR is sourced from the operational teams within the business. In this document, we have provided details of the:

- data used to populate the tables;
- basis used for allocating income and expenditure; and
- basis of management assumptions made in the allocation methodology.

2. Areas of responsibilities

<i>Area</i>	<i>Owner</i>	<i>Process / activity</i>
<i>All financial tables</i>	<i>Group Finance – Regulatory Accounting & Reporting</i>	<p>Communicate regulatory reporting requirements and guidance to finance and non-finance stakeholders involved in the APR process.</p> <p>Co-ordinate delivery of APR tables and complete reconciliations between the statutory position and related tables.</p> <p>Co-ordinate external assurance for the regulatory tables.</p>
<i>Operational expenditure (Opex)</i>	<i>Finance business partners – Customer Operations, Capital Delivery, Retail & Commercial and Support</i>	<p>Determine cost allocation methodologies for price control and upstream services.</p> <p>Determine cost allocation methodology for third party and non appointed activities.</p> <p>Apply above cost allocation methodologies to year end financials and produce Opex tables.</p> <p>Undertake variance analysis against prior year and final determination.</p>
<i>Capital expenditure (Capex)</i>	<i>Strategic Asset Planning team</i>	<p>Review source data capital expenditure assignments to Capex regulatory categories for accuracy and provide cost allocation methodologies where applicable.</p>
	<i>Financial business partners - Capital Delivery & Commercial</i>	<p>Apply cost allocation methodologies to year end financials and produce Capex tables.</p> <p>Undertake variance analysis against prior year and final determination.</p>
<i>Fixed assets</i>	<i>Capital Accounting team</i>	<p>Prepare fixed asset tables by business unit and perform reconciliation between the statutory and regulatory position.</p> <p>Provide retail depreciation numbers for retail tables.</p>
<i>Revenue</i>	<i>Income and debt team</i>	<p>Analysis of revenue between regulatory categories.</p>
	<i>Finance business partners - Wholesale & Retail Revenue</i>	<p>Undertake variance analysis against prior year and final determination.</p>

3. Cost allocation principles

Our approach to accounting separation applies the general principles set out in RAG 2.09 and RAG 5.07. Ofwat has set out the following general principles which we are required to comply with.

<i>Principle</i>	<i>OFWAT requires that...</i>	<i>At Hafren Dyfrdwy...</i>
<i>Transparency</i>	The cost attribution and allocation methods applied to allocate costs within the APR need to be transparent. This means that the costs and revenues apportioned to each service or segment should be clearly identifiable. The cost and revenue drivers used within the system should be clearly explained to enable robust assurance against this guidance.	Our accounting separation methodology is transparent. Direct costs to price controls are identifiable and can be traced back to our SAP ledger. Methodologies for allocated costs are captured in Process Description Templates ('PDTs').
<i>Causality</i>	Cost causality requires that costs (and revenues) are attributed or allocated to those activities and services that cause the cost (or revenue) to be incurred. This requires that the attribution or allocation of costs and revenues to activities and services should be performed at as granular a level as possible.	Wherever possible, bases for costs are allocated to activities that cause the cost to be incurred. Some costs are more remote from the activities being allocated across than others (for example costs of regulation). The method applied to allocating such costs is described in the methodology statement.
<i>Non-discrimination</i>	The attribution or allocation of costs and revenues should not favour any price control unit or appointed/non-appointed business and it should be possible to demonstrate that internal transfer charges are consistent with the prices charged to external third parties.	Cost allocation bases are as objective as possible and are not designed to favour any price controls or associated companies.
<i>Objectivity</i>	The cost and revenue attribution criteria need to be objective and should not intend to benefit any price control unit or appointed/non-appointed business. Cost allocation must be fair, reasonable and consistent.	Cost allocation bases are as objective as possible and are not designed to favour any price controls or associated companies.
<i>Consistency</i>	Costs should be allocated consistently from year to year to enable meaningful comparison of information over time. Changes to the attribution methodology from year to year should be clearly justified and documented.	We have been consistent in our cost allocation methodology. Any changes made are outlined below.
<i>No cross subsidy between price controls</i>	Companies should also ensure that there is no cross subsidy between price control units. In accordance with RAG 5, transfer prices for transactions between price control units should be based on market price unless no market exists, in which case transfer prices should be based on cost.	In line with the separate binding price controls introduced in 2014, costs are compliant with RAG 5 'Guideline for transfer pricing in the water and sewerage sectors.'
<i>Principal use</i>	Where possible, capital expenditures and associated depreciation should be directly attributed to one of the price control units. Where this is not possible as the asset is used by more than one service, it should be reported in the service of principal use with recharges made to the other services that use the asset reflecting the proportion of the asset used by the other services.	Where possible assets and associated depreciation are directly attributed to the relevant price control and applied the principal use guidance for shared assets.

4. Recharges to/from associated companies

The process to allocate costs between price controls begins after services supplied by/to the appointee have been recharged.

The recharge process undertaken by Severn Trent Water is outlined below.

The recharges include both ad-hoc costs and recurring charges. Ad-hoc or one off expenses are recharged via an intercompany process usually within the month they are incurred. There is a Corporate Services Agreement ('CSA') in place between Severn Trent ('ST') and HD, which outlines the services undertaken by the support functions in ST on behalf on HD. These services are agreed in advance, and reviewed on a quarterly basis including the charge and activity being undertaken. For these recurring charges there is an established management recharge process which is undertaken on a quarterly basis to transfer expenses to/from associated companies. An overhead charge is added to this to account for the indirect costs associated with the activity. This is a percentage calculation which takes the expenditure on support functions over the total expenditure (excluding financing costs) undertaken within the business. The calculation is reviewed on an annual basis. The total direct and indirect cost is recharged to the relevant associated company.

Where management and general ('M&G') assets are utilised in the provision of the service, a use of asset recharge is separately calculated and recharged.

The information is completed by the relevant support teams within the business and collated within Finance. The returns are reviewed by the Performance and Planning teams to ensure that recharges are accurate and complete. Any new activities within the company are raised by the analysts on an ongoing basis to ensure these are incorporated within the recharge process.

The price control allocation process therefore begins after recharges to/from associates has been completed.

Integration of Hafren Dyfrdwy operational activities into SAP

In 2018/19, following the alignment of the England and Wales boundaries between Severn Trent and Hafren Dyfrdwy, the SAP system was configured to allow recharge of operational activities between the two companies.

Severn Trent Water records the costs for operational activities undertaken in Powys and recharges to Hafren Dyfrdwy and Hafren Dyfrdwy records the costs for operational activities undertaken in Chester and recharges to Severn Trent Water.

The recharge takes place using the SAP Work Force Management ('WFM') functionality and planning and scheduling systems. The work order is booked to Severn Trent Water or Hafren Dyfrdwy based on the functional location ('FLOC') of the asset. If the asset has a Hafren Dyfrdwy FLOC then an appropriate Hafren Dyfrdwy cost centre will incur the costs for the job.

Costs will recharge automatically from Severn Trent to Hafren Dyfrdwy through time booked to work orders, at a rate calculated to include direct and indirect manpower and non-manpower costs (fuel, vehicle and PPE). The rate is reviewed annually by the Customer Network Operations Finance Team and is updated in WFM.

Any other costs booked to a work order not included in the rate (e.g. materials) will also follow the work order and move between Severn Trent Water and Hafren Dyfrdwy automatically.

A summary of the recharges can be found in the supplementary disclosures within the Annual Performance Report.

5. Operating costs accounting separation process

The Tagetik budgeting, planning and forecasting system is used to populate the operating expenditure section of wholesale Totex analysis and retail operating cost analysis (Tables 2B, 2C, 4D, 4E, 4J and 4K). Cost centre financials and cost driver price control allocation percentages are held in the system, allowing calculation of costs at a price control and business unit level.

Inputs into the accounting separation model undergo a review process:

- first stage review is performed in the relevant business area;
- second stage review is performed by the regulatory accounting team and other regulatory stakeholders; and
- third stage review is performed by external and internal assurance providers to confirm the cost allocation principles comply with the regulatory requirements.

First stage review applies to all inputs, second and third line review is on a sample basis based on risk factors.

The table outputs of the model are reviewed and signed off by the senior finance management team for each respective area.

The operating costs accounting separation process is further detailed below:

Owner(s)	Process / activity
<i>Finance business partners – Customer Operations, Capital Delivery & Commercial, Retail and Support</i>	PRICE CONTROL AND BUSINESS UNIT/ACTIVITY ASSIGNMENT
	Identify 'direct' cost centres for each respective area and assign to business units within price controls.
	Identify 'shared' cost centres containing management costs, operational support costs and general and support costs which are utilised across price controls and determine appropriate cost driver to allocate the costs between price controls.
	Complete a process documentation template (PDT) for each cost driver. The PDT gives an overview of the business area and nature of activity (including non-appointed activities)
	The PDT also provides information on the cost driver applied, compliance to RAGs, and justification for assumptions made. The process for calculating the allocation percentages is documented.
	Perform year end cost allocation calculations following the process outlined in each PDT to determine the year end allocation percentage.
<i>Finance business partners – Customer Operations, Capital Delivery & Commercial, Retail and Support</i>	NON-APPOINTED AND THIRD PARTY COSTS
	Identify non-appointed and third party costs by referring to the guidance in the income categorisation table in RAG 4 to ensure completeness.
	Complete a PDT for each activity. The PDT gives a description of the non-appointed activities and the type of costs incurred.
	The PDT also outlines the transfer price basis for the activity (market/cost) including recharge of overheads.
	A use of asset recharge methodology is included to reflect the use of appointed assets in the non-appointed operations if applicable.
	A financing charge methodology is included to cover the cost of capital associated with financing the assets where applicable.
	The transfers to non-appointed and third party costs are made before further price control allocations are applied.
Perform year end calculations and review calculations performed by Management Accounting on their behalf.	

<i>Group Finance – Regulatory Accounting & Reporting</i>	APPLICATION OF ALLOCATIONS TO YEAR END FINANCIAL VALUES
	Assign cost centre and cost driver information in the PDTs to the applicable costs centres and cost groupings in the model.
	Adjust the total costs to account for items which are not captured in the report e.g. revenue reclassifications and exceptional items.
	Perform year end cost allocation calculations for specific PDTs.
<i>Group Finance – Regulatory Accounting & Reporting</i>	UPSTREAM SERVICES ALLOCATIONS
	Determine upstream allocation principles by the use of financial/non-financial information or management estimate where management information is unavailable.
	Calculate and apply allocation percentages based on methodology provided above.
<i>Group Finance – Regulatory Accounting & Reporting</i>	RECONCILIATION
	A reconciliation is performed to ensure that the total operating expenditure has been allocated to a price control or classified as non-appointed and that all cost centres identified as having shared costs are zero post allocation.
<i>Finance business partner leads and senior finance managers for respective table owners Regulatory Accounting team Strategy & Regulation team</i>	REVIEW PROCESS
	Review the final accounting separation tables.

6. Changes in allocation methodology

Where it is not possible to allocate costs directly to price controls, we look to keep the methods of apportionment as consistent as possible. In the current year, there are no material changes to the cost allocation methodology.

7. Wholesale variance analysis to the prior year

Wholesale Water

Opex analysis – excluding atypicals

<i>Operating expenditure</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
Water Resources					
<i>Power</i>	(0.048)	(0.026)	(0.022)	-82.9%	Driven by increased water into supply.
<i>Income treated as negative expenditure</i>	0.293	0.478	(0.185)	38.7%	
<i>Bulk supply</i>	(0.397)	(0.362)	(0.035)	-9.6%	
<i>Renewals expensed in year (Infrastructure)</i>	(0.080)	(0.543)	0.454	85.0%	Higher value in prior year driven by work that was completed in AMP6.
<i>Renewals expensed in year (Non Infrastructure)</i>	0.000	0	0.000	0.0%	
<i>Other operating expenditure - excluding renewals</i>	(1.766)	(0.314)	(1.452)	-462.5%	More work being undertaken in this year as expected within water resources. This also includes a £1m accrual relating to one of our dams.
<i>Local authority and Cumulo rates</i>	0.278	(0.430)	0.708	164.5%	Rates includes a refund relating to AMP5, which we have discussed in our 4C commentary on page 111 of our APR.
<i>Abstraction charges/ discharge consents</i>	(0.610)	(0.557)	(0.053)	-9.5%	
Raw Water Distribution					
<i>Power</i>	(0.627)	(0.567)	(0.060)	-10.5%	Driven by increased water into supply.
<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk supply</i>	(0.159)	(0.132)	(0.027)	-20.2%	Increase due to larger volume supplied.

Operating expenditure	Current year figures (£m)	Prior year figures (£m)	Variance (£m)	Variance (%)	Commentary
<i>Renewals expensed in year (infrastructure)</i>	0.000	(0.006)	0.006	100.0%	
<i>Renewals expensed in year (non infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Other operating expenditure – excluding renewals</i>	(0.207)	(0.215)	0.008	3.7%	
<i>Local authority and cumulo rates</i>	0.089	(0.143)	0.232	161.9%	Rates includes a refund relating to AMP5, which we have discussed in our 4C commentary on page 111 of our APR.
<i>Abstraction charges/ discharge consents</i>	0.000	0.000	0.000	0.0%	
Water Treatment					
<i>Power</i>	(0.089)	(0.089)	0.000	-0.2%	
<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk supply</i>	(0.526)	(0.398)	(0.128)	-32.1%	Increase due to larger volume supplied.
<i>Renewals expensed in year (infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Renewals expensed in year (non infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Other operating expenditure excluding renewals</i>	(3.210)	(2.838)	(0.372)	-13.1%	
<i>Local authority and cumulo rates</i>	0.058	(0.106)	0.164	154.5%	Rates includes a refund relating to AMP5, which we have discussed in our 4C commentary on page 111 of our APR.
<i>Abstraction charges/ discharge consents</i>	(0.025)	(0.023)	(0.002)	-9.5%	
Treated Water Distribution					

<i>Operating expenditure</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
<i>Power</i>	(1.387)	(1.301)	(0.086)	-6.6%	Driven by increased water into supply.
<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk supply</i>	(2.294)	(1.723)	(0.571)	-33.1%	Increase due to larger volume supplied.
<i>Renewals expended in year (infrastructure)</i>	(2.970)	(4.514)	1.544	34.2%	Year on year movement is due to a reduction in mains renewal activity, with 11km in FY20 and 4km in FY21.
<i>Renewals expended in year (non infrastructure)</i>	0.000	(0.002)	0.002	100.0%	
<i>Other operating expenditure - renewals expended in year (Infrastructure)</i>	(4.536)	(4.331)	(0.205)	-4.7%	
<i>Local authority and cumulo rates</i>	0.481	(0.801)	1.282	160.1%	Rates includes a refund relating to AMP5, which we have discussed in our 4C commentary on page 111 of our APR.
<i>Abstraction charges/ discharge consents</i>	0.000	0.000	0.000	0.0%	

Capex analysis

The net Water Capex investment in 2020/21 was £14.1 million. This is £0.2 million (1%) higher than the net investment in 2019/20 and is in line with our delivery programme which reflects investment to support delivery of our performance commitments and statutory requirements. The significant variances by business unit are explained below:

<i>Business unit</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
Water Resources	7.143	0.996	6.147	617.2%	We have undertaken investigations of four reservoirs which have confirmed c. £4.7 million of work to be completed under Section10 notice. We have accrued for this in in 2020/21, which is driving the year on year variance.

Raw Water Distribution	0.000	0.002	-0.002	-	
Water Treatment	0.705	1.614	-0.909	-56.3%	Expenditure was higher in the prior year due to completion of AMP6 work. In current year, expenditure is in line with expectations of the business plan.
Treated Water Distribution	6.053	11.165	-5.112	-45.8%	Expenditure was higher in the prior year due to completion of AMP6 work on distribution services reservoirs. This year expenditure has reduced in line with the business plan forecast.
Total	13.901	13.777	0.124	0.9%	

Wholesale Waste Water

Opex analysis

<i>Operating expenditure</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
Sewage Collection					
<i>Power</i>	(0.105)	(0.114)	0.009	7.7%	
<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk Supply</i>	(0.002)	(0.013)	0.012	87.7%	
<i>Renewals expensed in year (infrastructure)</i>	(0.302)	(0.091)	(0.211)	-232.3%	Increased maintenance activity on our sewer network as forecast in our business plan.
<i>Renewals expensed in year (non infrastructure)</i>	0.000	-0.030	0.030	100.0%	
<i>Other operating expenditure excluding renewals</i>	(0.439)	(0.400)	(0.039)	-9.8%	
<i>Local authority and cumulo rates</i>	(0.003)	0.001	(0.004)	345.3%	
<i>Abstraction charges/ discharge consents</i>	(0.028)	(0.026)	(0.002)	-9.5%	
Sewage Treatment					
<i>Power</i>	(0.354)	(0.374)	0.020	5.4%	

<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk Supply</i>	0.000	(0.016)	0.0016	-	
<i>Renewals expensed in year (infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Renewals expensed in year (non infrastructure)</i>	0.000	(0.001)	0.001	100.0%	
<i>Other operating expenditure excluding renewals</i>	(2.030)	(1.754)	-0.277	-15.8%	
<i>Local authority and cumulo rates</i>	(0.284)	(0.282)	-0.002	-0.8%	
<i>Abstraction charges/ discharge consents</i>	(0.187)	(0.171)	-0.016	-9.5%	
Sludge					
<i>Power</i>	(0.001)	(0.001)	0.000	-35.5%	
<i>Income treated as negative expenditure</i>	0.000	0.000	0.000	0.0%	
<i>Bulk Supply</i>	0.000	(0.006)	0.006	100.0%	
<i>Renewals expensed in year (infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Renewals expensed in year (non infrastructure)</i>	0.000	0.000	0.000	0.0%	
<i>Other operating expenditure - excluding renewals</i>	(0.543)	(0.458)	-0.085	-18.5%	Increased volume of sludge exported leading to a higher cost incurred.
<i>Local authority and cumulo rates</i>	0.000	0.000	0.000	-	
<i>Abstraction charges/ discharge consents</i>	0.000	0.000	0.000	0.0%	

Capex analysis

Overall the waste water net Capex investment in 2020/21 was £1.224 million. This is £0.562 million (31.5%) lower than the net investment in 2019/20 and is in line with our delivery programme which reflects investment to support delivery of our performance commitments and statutory requirements. The significant variances by business unit are explained below:

<i>Business unit</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
Sewage Collection	0.131	0.357	(0.226)	-63.3%	As expected, our expenditure has fallen year on year due to completion of projects in AMP6.
Sewage Treatment	1.093	1.352	(0.259)	-19.2%	As expected, our expenditure has fallen year on year due to completion of projects in AMP6.
Sludge	0.000	0.077	(0.077)	-	In line with our plan, we had no capex investment in this year.
	1.224	1.786	(0.562)	-31.5%	

Additional commentary

In the APR on page 111 4C commentary we set out where our in year expenditure has varied from our business plan, including details of timing adjustments.

8. Retail variance analysis to the prior year

Retail household

Retail household total operating costs of £2.013 million are £0.5 million (19.9%) lower than the prior year. An analysis of significant variances is outlined below:

<i>Business unit</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
<i>Customer services</i>	(0.301)	(0.357)	0.056	15.7%	Costs have dropped year on year, and are favourable to the business plan due to efficiencies within the customer team which has enabled the absorption of work relating to customer enquiries and complaints.
<i>Debt management</i>	(0.304)	(0.349)	0.045	12.8%	
<i>Doubtful debts</i>	(0.952)	(1.097)	0.145	13.3%	While doubtful debt has reduced year on year, it is still higher than forecast due to the adverse impact of COVID-19.
<i>Meter reading</i>	(0.168)	(0.151)	(0.017)	-11.0%	
<i>Services to developers</i>	0.000	0.000	0.000	0.0%	
<i>Other operating expenditure</i>	(0.289)	(0.558)	0.269	48.3%	Other operating expenditure has reduced due to efficiencies and a change in proportion of cost drivers resulting in a lower allocation of support costs.
<i>Depreciation and amortisation</i>	0.524	(0.535)	(0.011)	2.1%	
<i>Local authority and Cumulo rates</i>	0.000	-	-	-	

Retail non-household

Retail non-household total operating costs of £0.481 million are £0.253 million (111.1%) higher than the prior year. An analysis of significant variances is outlined below:

<i>Business unit</i>	<i>Current year figures (£m)</i>	<i>Prior year figures (£m)</i>	<i>Variance (£m)</i>	<i>Variance (%)</i>	<i>Commentary</i>
<i>Customer services</i>	(0.083)	(0.082)	(0.001)	-0.9%	
<i>Debt management</i>	0.000	0.000	0.000	0.0%	
<i>Doubtful debts</i>	(0.283)	0.011	(0.294)	2671.6%	Doubtful debt has gone up year on year due to the impact of COVID-19.
<i>Meter reading</i>	(0.002)	(0.002)	0.000	-16.1%	
<i>Services to developers</i>	0.000	(0.070)	0.070	100.0%	
<i>Other operating expenditure</i>	(0.113)	(0.085)	(0.028)	-33.5%	
<i>Depreciation and amortisation</i>	0.106	(0.114)	(0.008)	6.7%	
<i>Local authority and Cumulo rates</i>	0.000	-	-	-	

9. APR Section 2 Methodology – Price review and other segmental reporting

2A Segmental income statement

The segmental income statement analyses the appointed activities' operating profit between price controls and summarises the recharges made to/from other segments for the use of fixed assets.

2A line item	Price controls	Data source	Process
Revenue price control	All	SAP general ledger codes which captures the financial values for wholesale and retail charges via an interface from the main billing system (Target).	Assign each revenue code to wholesale water and waste water charges and retail revenue to retail household. Refer to table 2I for further detail.
Revenue non price control	All	SAP general ledger codes which captures the financial values for all non price control revenue via the receivables billing ledger.	Separate general ledger codes are created for each non price control revenue stream. Each revenue stream is assigned to an income category using the guidance in the Income categorisation table included in RAG 4. Price control assignment takes place when the transaction is posted in SAP, against profit centres which are assigned to price controls. Specific items that are netted off against operating costs within the statutory accounts are grossed up and shown as revenue for regulatory reporting. Such examples are developer contributions for administration costs which are incurred in relation to new connections and recharges for repair of damages costs. A review is performed at the end of the year to ensure that the correct price control assignment has been made and adjusted where necessary.
Operating expenditure – excluding PU recharge impact	Retail	Table 2C Cost analysis - retail	Refer to table 2C for more detail
PU opex recharge	Retail	Table 2C Cost analysis - retail	Refer to table 2C for more detail
Operating expenditure including PU recharge impact	Retail Wholesale water and waste water	Table 2C Costs analysis – retail Table 2B Totex analysis – wholesale.	Operating costs from table 2C. Refer to table 2C for further detail. Operating costs from table 2B. Refer to table 2B for further detail.

Depreciation and amortisation	All	Table 2D – Historic cost analysis of tangible fixed assets	Depreciation and amortisation charges are charged to the principal user price control.
		Table 2O – Historic cost analysis of intangible fixed assets	Refer to table 2D and 2O for further detail.
		SAP fixed asset register	
PU recharge impact	All	SAP fixed asset register and Accounting Separation model	Asset depreciation charges are used as a proxy for the transfer price recharges between price controls for the use of shared assets.
			All management and general asset cost centres are assigned an appropriate Opex cost driver to allocate costs across price controls. The same cost driver determines the relative proportion of depreciation that should be assigned to each price control. The price control with the largest allocation is deemed to be the principal user. The full depreciation cost for these assets is charged to the principal user. The recharge to/from segments is then calculated using the cost drivers allocation percentages applied to the depreciation charge.
Other operating income	All	SAP fixed asset register	Analysis of profit/loss on disposal of assets by reference to the cost centre and related profit centre the asset was assigned to when in use.
Surface water drainage (SWD) rebates	Water	System report using data in main billing system (Target).	A system report is run which identifies the value and the volume of SWD rebates issued for the required period.

2B Totex analysis – wholesale

The wholesale Totex analysis disaggregates the wholesale price control costs into water resources, water network+, waste water network+ and sludge by assignment of business units outlined below:

<i>Price control</i>	<i>Business unit</i>
Water resources	Water resources
Water Network+	Raw water distribution Water treatment Treated water distribution
Waste water network +	Sewage collection Sewage treatment
Sludge	Sludge collection Sludge treatment Sludge disposal

Assignment of cost centres into direct business units occurs at the same time that the price control assignment is carried out. Cost centres which are identified as being shared between price controls are allocated to a

business unit by using either the same cost driver used to allocate at price control level or by a different cost driver if more appropriate. Cost centres which relate entirely to a price control but more than one business unit are allocated using appropriate cost drivers.

Business unit allocations are explained below:

Operating Expenditure – Wholesale price controls

<i>Operating expenditure</i>	<i>Expense type</i>	<i>Price control</i>	<i>Business unit allocation</i>
Power	Power	Water Resources and Water Network plus	Average pumping head allocation based on non-financial data in Table 4P. The average pumping head calculation methodology outlined in RAG 2 is applied and the reservoir classification outlined in RAG 4 is applied to arrive at water resources and water network+ allocation.
		Waste water	Direct assignment to cost centre which is assigned to business unit based on their activities.
	Shared Carbon Reduction Commitment payments	All wholesale price controls	Allocated based on direct costs of power charged to price controls.
Income treated as negative operating expenditure	Hydro feed-in tariff income	Water Resources	100% water resources (hydro generation).
Service charges	Abstraction charges	Water resources	100% Water resources.
	Discharge consents (water treatment)	Water network plus	100% Water treatment.
	Surface water network	Waste water network plus	100% Sewage collection.
	Discharge consents	Waste water network plus	100% Sewage treatment.
Bulk supply	Treated water supplies	Water network plus and water resources	Pro-rated based on the associated company prior year Table 4D APR splits between water resources & water network +.
	Bulk waste water supplies	Waste water network plus and bioresources	Pro-rated based on the associated company prior year Table 4E APR splits between waste network + and bioresources

Renewals expenses in the year (infrastructure)	Infrastructure renewals expenditure	All wholesale price controls	Refer to Capital expenditure section below.
Renewals expenses in the year (non-infrastructure)	Non-infrastructure (NI) renewals expenditure	All wholesale price controls	Non-infrastructure renewals expenditure is included in hired and contracted, materials and consumables and employment costs within the respective cost centres incurring the costs. To identify these separately a work force management report is run selecting the activity types associated with NI renewals. The expenditure of the activity types is deducted from the expense line in the relevant cost centres and reclassified to the NI renewals line.
Other operating expenditure	<ul style="list-style-type: none"> • Employment costs • Hired and contracted services • Materials and consumables • Other costs – utility costs, insurances, bad debt costs, OFWAT fees, fines, subscriptions, postage & printing, defined benefit administration fee, audit fees and recharges to/from other group companies 	Allocated to wholesale price controls directly based on activity or by the use of appropriate cost drivers	<p>Directly allocated to business units by the use of cost centres which are assigned to business units.</p> <p>Where other costs relate to more than one business unit they are allocated between the business units by:</p> <ul style="list-style-type: none"> • identifying specific cost drivers by retrieving the relevant management information; • management estimate where management information is not available; or • allocation of management and supervisory costs in line with allocation methodology of direct teams • appropriate FTE cost driver depending on the operational area the costs are supporting

Local authority rates	This includes both local authority rates and cumulo rates.	Water network plus and water resources (cumulo)	Pro rata to the gross MEAV value of infrastructure and non-infrastructure assets assigned to each water business unit.
		Waste water network plus	Based on non-infrastructure gross MEAV of waste water assets into Sewage treatment.
		All wholesale price controls (office buildings)	Floor space occupied.
Third party services	Fire hydrants	Water network plus and water resources	Treated water distribution
	Bulk water supplied		Water resources (non-potable) and Water Network + (potable) in line with revenue charging methodology
	Hydro dams and reservoir management		Water resources
	Bulk waste water supplies	Waste water and bioresources	Waste network + and Sludge costs calculated in line with revenue charging methodology

Costs relating to general and support (G&S) activities are assigned to the appropriate cost line above and are allocated to price control and business units using costs drivers outlined in Section 11.

Capital expenditure

- The Hafren Dyfrdwy capital expenditure data by project uses two data sources; the legacy data is on an excel document and all projects have been moved in to SAP Business Warehouse from 1st July 2018.
- The SAP Business Warehouse report produces a detailed report of renewals expenditure and capital expenditure and income by business plan line ('BPL'). Each BPL consists of a series of individual projects, with a total of c. 200 projects over the capital programme.
- The capital expenditure projects in the excel document have been recorded line by line for 2018/19. This has been analysed on a project by project basis against the business unit activities and related assets outlined in RAG 4. Each project is been assigned a BPL to allow regulatory categorisation.
- Each BPL is aligned to a regulatory driver and can have a one-to-one or one-to-many relationship. The drivers are listed below and recorded in the below lines of the Totex table:

Regulatory driver	Table line	Infrastructure/non-infrastructure allocation
Infrastructure renewals expenditure (IRE)	2B.5, 4J.5 and 4K.5	100% infrastructure
Maintenance non-infrastructure (MNI)	2B.16, 4J.16 and 4K.16	100% non-infrastructure
Enhance levels of service Quality	2B.17 and 2B.18	Infrastructure/non-infrastructure allocation determined by the purpose

Supply/demand balance

code mapping which is assigned at source in SAP

- The regulatory mapping is assigned at source level in SAP with each project being assigned to a business plan line attributed to Water Resources, Water Network +, Waste Network +, Bio-resources or Management & General.
- The price control BPL assignment is determined by reference to the nature of the spend in the BPL against the regulatory assets, activities and boundaries outlined in RAG 4.
- An annual review of mappings is performed for the current year end. Where it is deemed that the mapping requires updating due to a change to the delivery of the project since the initial mapping (due to change in scope or solution), the regulatory assignments are updated.
- A download of the capital programme is reviewed at the year end by the Strategic asset planning team to identify any expenditure which may have been coded incorrectly at source so this can be corrected.
- The exercise also includes assigning the expenditure to business unit level to complete tables 4D and 4E. Assignment can be at the BPL in total or by analysis within BPL if appropriate. The business unit BPL assignment is determined by reference to the nature of the spend in the BPL/project against the regulatory assets, activities and boundaries outlined in RAG 4.
- The assignment of material schemes/projects is also reviewed by Strategic Asset Planning (in S&R).
- The total income and expenditure is reconciled to the year end schedules produced by the Capital Accounting team, the net IRE expenditure including IRE income is then recorded in to the operating expenditure section of the Totex tables.
- M&G expenditure is allocated as below:

Capex spend	Price control/business unit allocation
<i>IT projects – retail IT spend</i>	Allocated entirely to retail.
<i>IT projects – wholesale IT spend</i>	Based on management estimate.
<i>Property projects</i>	Based on the nature of spend, the area of the business it benefits and the property/site it relates to.

Cash Expenditure

Cash expenditure items have been allocated as below:

Cash expenditure	Price control allocation	Business Unit allocation
<i>Pension deficit recovery payments</i>	Pro-rate cost against the number of employees in each price control who are members of the scheme.	Direct net employment costs at business unit level.

2C Operating cost analysis – Retail

Where cost centres do not have teams aligning to discrete retail activities, the initial allocation of costs into retail activities e.g. billing or payments handling have been apportioned based on management information or management estimate. The apportioned costs to the retail activities are subsequently allocated to retail household and non-household referring to RAG 2 for guidance on allocation.

Costs associated with the relevant cost centres are downloaded from the financial ledger using a SAP Business Warehouse report and used as the starting point for the allocation of costs to activities. In addition, there are certain costs which are recorded outside of the retail operational teams but which are included in the retail price

control for regulatory reporting. These costs are identified and transferred from the relevant areas of the business.

Retail recharges from other business areas

General and Support Expenditure – General and support expenditure is allocated to retail using appropriate cost drivers determined for each support function and is recorded in Other operating expenditure. Please refer to section 11 for the general and support allocation methodology.

Team responsibilities and allocation to activities

<i>Business Area</i>	<i>Team(s) / activity</i>	<i>Retail activity types</i>	<i>Cost allocation/driver</i>
Metering Services	Costs relating to planning, scheduling and execution of meter reads. Predominantly people costs + costs of fuel, lease vehicles for meter readers.	Meter Reading	100% allocation
Credit Management	People + third party costs relating to chasing debt and litigation (court costs).	Debt management	100% allocation
	The bad debt charge sits within this cost centre.	Doubtful debt expense	100% allocation
Customer Contact	Costs predominantly relate to people costs of call centre agents and team leaders in relation to frontline Customer Service operational call centres and to Customer Contact and Credit Management.		<p>The costs within the Customer Contact centre need to be first split based on the activities the individuals in the cost centres are undertaking.</p> <p>Specific individuals focus on debt collection and the remainder focus on a mixture of billing and payment handling and other queries. The costs attributed to the proportion of people focusing on debt is directly allocated to debt management retail activity. The remaining individuals are then split on the basis of customer contact volume.</p> <p>The customer contact volume report is provided by the operational team and breaks down all contacts by reason. Once all reasons have been assigned to a retail activity, a sum of the number of contacts for each retail activity is performed and shown as a % of the total volume of contacts.</p>

Allocation to household and non-household retail

<i>Business Area</i>	<i>Basis of allocation</i>	<i>Process</i>
Billing	Number of bills raised	Split is determined using the bill volumes sent to household and non-household customers.
Payment handling, remittance and cash handling	Number of payments received from each group of customers	The costs associated with the total number of payments by each account type split by household and non-household.
Vulnerable customer services	Direct allocation	100% to household
Non-network customer enquiries and complaints	Number of household and non-household customer complaints	Pro-rated to household and non-household
Network customer enquiries and complaints	Number of household and non-household customer complaints	Pro-rated to household and non-household
Network customer enquiries and complaints (Investigatory visits).	Direct costs of household and non-household jobs	Investigatory visits / first visit to the customer costs are recharged from wholesale. Retail household and non-household category and related costs are captured through work orders.
Other direct costs	Number of household and non-household customers	Pro-rated to household and non-household
Debt management	The household and non-household proportion is based on debt write-off	Debt management costs are split using the value of aged debt over 1 year
Doubtful debts	Split of bad debt charge	Split of bad debt charge based on proportion of revenue
Meter reading	Number of meter reads	The costs are allocated between household and non-household based on the number of reads
Services to developers	Direct allocation	100% to non-household
Customer side leaks	Direct costs of household and non-household jobs	The costs of the initial visit and follow up visit including repair costs along with the associated FTE are recharged to retail. Retail household and non-household category and related costs are captured through work orders.

2D Historical cost analysis of fixed assets - Wholesale and Retail

The tangible fixed asset table is calculated allocating assets in the SAP fixed asset register to price control via use of cost centres and profit centres and allocating the work in progress ('WIP') to price control via analysis of projects.

FIXED ASSET REGISTER

The full historical cost fixed asset register is downloaded into excel. Each asset has a cost centre assigned to it. Additional attributes are added to the data to enable the completion of the fixed asset table:

- Infrastructure/non-infrastructure classification - this classification is based on the asset class code given to the asset
- Income/expenditure classification - as the fixed asset table excludes capital income (which is reclassified to deferred income in the balance sheet), all income asset class codes are excluded from the table
- Intangible/Tangible classification - Table 2D is only applicable for tangible assets, therefore intangible assets are excluded
- The profit centre that the cost centre is assigned to is added to the register by looking up to a SAP cost centre download provided by Management Accounting. This is used to determine the price control and the relevant business unit and support area for Management & General ('M&G') assets
- An adjustment is made to change the profit centre where the profit centre assigned to the cost centre was set up incorrectly in SAP

M&G principal user assignments

The percentages from the G&S Opex allocations are applied to determine the principal user to be identified. This is the business unit with the highest percentage allocation. Where the finance business partner believes that the asset principal user is different from the Opex percentages or where there is no Opex activity in the cost centre, the principal user identified by the finance business partner is used instead.

Principal user cannot change year on year so once it has been assigned this is permanent. Recharges to/from calculations for Table 2A are then determined by multiplying the relevant depreciation by the Opex cost drivers

Management and general assets are assigned to a principal user using the following bases:

Business area	Basis of assignment
Information systems	Assignment using IS business area costings
Transport	Assignment on the basis of vehicle recharges
Property services	Assignment on the basis of floor space used

Reclassifications

Other adjustments are made to record changes required to the underlying fixed asset register. This may be because assets have been posted to the incorrect cost centre at source or to include late adjustments at year end posted in Tagetik once SAP has closed.

Other Adjustments

All entries in the fixed asset register are posted to the SAP general ledger in specific GL codes which only allow auto-postings from the fixed asset register and WIP listing. There is sometimes a requirement to enter journals in addition to the auto postings, these are posted into manual GL codes.

Year on year journals to manual codes include the gross depreciation accrual. The price control assignment is determined from the site the accrual relates to.

Other one-off adjustments relate to journals arising during the year end process but are posted directly into Tagetik rather than SAP as the ledgers have closed. The price control assignment is determined from the site the adjustment relates to.

As a result of detailed activities in preparation for PR19, additional review activities have been performed in relation to accuracy of assets assigned to cost centres and price controls. This has led to transfers in the adjustments line in the cost and depreciation sections of the fixed asset table which related to resetting the opening position of the adjustments outlined above.

WORK IN PROGRESS

The WIP projects have been recorded line by line in an excel document for 2018/19. This has been analysed on a project by project basis against the business unit activities and related assets outlined in RAG 4.

A final reconciliation is performed between the net book value of the tangible assets in the statutory accounts to the regulatory accounts, the only difference expected being capitalised interest.

2E Analysis of grants and contributions – water resource, water network + and waste water network +

Grants and contributions have been allocated between water and waste water in accordance with the nature of the income. Grants and contributions fully recognised in the income statement relate to IRE income. All other grants and contributions received are capitalised and amortised against depreciation.

Connection charges are contributions received from developers for service connection charges for installing a new service pipe and meter. (Water Industry Act s45).

Infrastructure charge receipts are contributions received in the year for new connections. This reflects a contribution to the costs of enhancing the local water or sewerage network. (Water Industry Act s146).

Requisitioned mains are contributions received from developers to requisition a new water main or sewer. (Water Industry Act s43, 55, 56 & 100).

Diversions are contributions received from local authorities, highway authorities and private companies to divert water mains or sewers. (Water Industry Act s185).

Other contributions are received from organisations towards the construction of specific capital projects, e.g. health authorities for fluoridation or government departments for environmental schemes.

Value of adopted assets is taken from our monthly adoptions reconciliation which represents postings to the ledger and are from the project manager in developer services.

2F Residential retail

The Target MI billing system holds all customer data. For regulatory accounting purposes, a different customer field (Property Usage Code ('PUC')) is used to split revenues into customer types.

Properties categorised as voids are excluded from billing and will not form part of the overall customer categorisation. The overall proportion of voids will amount to an insignificant proportion of total customers. Number of households billed is fully provided from the corporate source systems for all categories and will be for Water only.

Customer numbers are provided from the Target billing system for all categories with the exception of line two (unmeasured waste water only) and line five (measured waste water only), which is provided by other water companies ('OWCs'), who bill on our behalf.

The customer numbers data has been subject to assurance in accordance with our Company Assurance Framework.

2G/H Non-household water and waste water - revenues by tariff type

For the reports for large user and non-standard water customers are taken from the Target MI system to give property numbers, wholesale and retail revenue, and volume usage for those customers broken down into the relevant revenue types (water/waste water). This billing data is then combined with the unbilled revenue accrual, which itself is broken down into wholesale/retail, water/waste water and property volumetric usage to calculate the total revenue (split wholesale and retail) at each tariff banding level.

The revenue calculated for each service is then checked against the following:

- Management Accounts reported revenue – this is to ensure that before taking into account any movements for the Regulated reported revenue the revenue calculated was accurate; and
- Table 2I – to ensure reported revenue is aligned appropriately for each service component.

2I Revenue analysis

The wholesale/retail charges are determined as part of the Charges Submission process. The agreed tariffs entered into Target by assigning each tariff to unique codes which identifies whether the tariff relates to (1) water resources, water network plus, waste water network plus or bioresources, (2) measured or unmeasured, (3) wholesale or retail charge, (4) household or non-household. Each code is interfaced to a GL account and profit centre in SAP based on the above categories.

All non-tariff general ledger income codes have been assigned to the below categories using guidance within the RAG 4 income categorisation table:

- Bulk supplies – water;
- Bulk supplies – waste water;
- Other third party revenue; and
- Principal services – non price control.

2J Infrastructure network reinforcement costs

- The Hafren Dyfrdwy data capital expenditure data by project is located in 2 different sources; the legacy data is on an excel document and all projects have been moved in to SAP Business Warehouse from 1st July 2018.
- A SAP business warehouse report produces a detailed view of infrastructure renewals expenditure and capital expenditure and income by project.
- Each project is assigned to a BPL which aligns to regulatory reporting and internal categories to allow reporting of capital expenditure against planned activity. The legacy projects are also assigned BPLs based on project activity.
- Specific business plan lines relate to infrastructure network reinforcement costs where the investment driver relates to managing supply demand balance specifically in relation to growth.
- Expenditure on low pressure improvements related to growth is included but expenditure on low pressure improvements related to enhanced service levels is excluded from the table.
- Expenditure on other non-growth related supply demand balance projects are excluded e.g. hot weather action plans
- The projects in the infrastructure network reinforcement BPLs are reviewed by a subject matter expert on completion of the table to ensure that expenditure has been correctly coded at source with adjustments made where required.

Water

- BPLs identified as water infrastructure network reinforcement growth lines are:
 - Network reinforcement off-site Capex - local reinforcements, hydraulic capacity (undersized assets) and strategic growth reinforcements
 - On-site Capex – new development and new connections expenditure
- A further categorisation of the expenditure is made into distribution and trunk mains and pumping and storage facilities where the former is all infrastructure expenditure and the latter is non-infrastructure. This categorisation is derived from the purpose mapping for each project which identifies if the spend is infrastructure (below ground) or non-infrastructure (above ground) related.

Waste

- Our existing Waste structure only has one network reinforcement growth BPL, therefore an analysis of projects to identify the on-site and off-site expenditure is conducted by a subject matter expert.
 - Network reinforcement off-site Capex - local reinforcements and strategic growth reinforcements
 - On-site Capex – requisitions and on-site adoptions expenditure
- A further categorisation of the expenditure is made into sewage collection (foul, combined and surface water only systems) and pumping and storage facilities where the former is all infrastructure expenditure and the latter is non-infrastructure. This categorisation is derived from the purpose mapping for each project which identifies if the spend is infrastructure (below ground) or non-infrastructure (above ground) related.
- Sewage collection expenditure is allocated 95% foul and combined systems and 5% surface water only systems. This is a management estimate based on analysis of projects which indicate that the majority of growth is as a result of foul flows and occasionally relate to upgrading the surface water systems.

2K Infrastructure charges reconciliation

The majority of the lines of the data is populated from other tables (table 2E and 2J).

Section A - Impact of infrastructure charge discounts

- Net infrastructure charge income is populated from table 2E.
- A SAP business warehouse report is run to find the value of infrastructure discount given on invoice. Any infrastructure charge refunds that have not been processed through SAP are added to the value to get total discount given.

Section B - Comparison of revenue and costs

- The variance brought forward from prior year related to FY20.
- The infrastructure charges revenue value is populated from gross revenue in section A of the table.
- The costs are populated from table 2J.

2L Analysis of land sales

Proceeds from disposal of protected land is the net proceeds, after the deduction of all offsetting costs from disposals of protected land.

2M Revenue reconciliation

Reconciliation of the revenue collected in year with the allowed revenue from the FD, setting out the imbalance between the two where one exists.

Wholesale revenue governed by price controls and grants and contributions flows into the table from tables 2I and 2E respectively; for information on how the revenue is captured please refer to those sections in this document.

As per RAG4.09, the other lines in this table are closely linked to the PR19 reconciliation rulebook, which provide the methodology for calculating the values.

The final section of the table mechanically calculates the imbalance between the actual revenue recovered and the revenue cap.

2O Historic cost analysis of intangible fixed assets

The process for table 2O follows that of table 2D – Historical cost analysis of tangible fixed assets, except applied to the intangible assets.

10. Upstream services

The wholesale water operating and capital expenditure is allocated to upstream service once the business unit allocation is complete by applying the below approach:

- (1) direct where appropriate;
- (2) by identifying specific cost drivers by retrieving the relevant management information; or
- (3) management estimate where management information is not available;

Capital expenditure allocated to upstream services is at the same point as business unit allocation by business plan line and purpose code analysis or once business unit allocation has occurred (if business plan line and purpose code cannot determine this) by use of appropriate cost driver based on management information or management estimate.

The table definitions in RAG 4 are used to identify the boundary points and assets in each upstream service to aid cost allocation.

Upstream Services - Water

Business Unit	Cost type	Upstream allocation
<i>Water resources (abstraction licences, raw water abstraction)</i>	<i>Abstraction charges</i>	100% Abstraction licences
	<i>All other costs</i>	100% Raw water abstraction
<i>Raw water distribution (raw water transport, raw water storage)</i>	Power	100% Raw water transport.
		Raw water storage uses negligible power
	Local authority rates	Allocated to raw water transport and raw water storage on the basis of the current cost gross book value of the assets attributed to each service.
	All other costs	100% Raw water transport
<i>Water treatment</i>		No disaggregation of water treatment to upstream services is required
<i>Treated water distribution</i>		No disaggregation of water treatment to upstream services is required

Upstream Services – Waste water

Business Unit	Cost type	Upstream allocation
<i>Sewage collection (Foul, surface water drainage, highway drainage)</i>	All cost types	Allocated on the basis of volume information collated during a 2018/19 project to raise visibility of sewerage charges for customers for a) foul water (including trade effluent), b) surface water draining from eligible premises and c) surface water draining from highways.

Definitions of each category are as follows:

Foul water is Dry Weather Flow ('DWF') with trade effluent at Sewage Treatment Works ('STW');

Surface drainage are surfaces types associated with residential and commercial premises that drain to our systems, e.g. Paved (Non Road), Domestic Drives & Patios;

Highway is any public road or other public way on land. It is used for major roads, but also includes other public roads and public tracks.

<i>Sewage treatment (Sewage treatment and imported sludge liquor treatment)</i>	All cost types	Not required.
<i>Sludge (Sludge transport, sludge treatment, sludge disposal)</i>	All cost types	Disaggregation between sludge transport, sludge treatment and sludge disposal occurs at the cost centre assignment stage in the accounting separation process applying the definitions in RAG 4, therefore no further disaggregation is required.

11. General and support allocation methodology

General and support costs are identified in the ledger by cost centre. These are apportioned between water, waste and retail following the rules detailed in the table below.

For some central functions where the tasks do not specifically relate to water, waste or retail, costs are allocated based on a FTE allocation percentage.

Employee FTE percentages have been used for allocation of general and support costs for specific functions across price controls and for a number of shared cost centres whose activity straddles more than one price control.

In SAP, FTE's are assigned to individual cost centres. A SAP business warehouse report identifies the number of FTE's in each cost centre on a monthly basis. This captures the below employees:

Direct – employees on the payroll, including fixed term contractors

Indirect – employees hired via our recruitment agency partner as contractors/agency

The average number of FTE's over the 12 month period is calculated for each cost centre.

Where FTE costs have been capitalised, these have been excluded to reflect the costs removed from operating expenditure. For costs identified as non-appointed, FTE's related to this activity have been removed based on the material costs associated with these activities.

The FTE numbers are grossed up for the number of wholesale/retail direct operations and operations support FTEs which are recharged from Severn Trent Water. This ensures that the support costs are being allocated to the areas utilising the costs.

Allocation of general and support expenditure between business areas.

<i>Type of cost</i>	<i>Basis of Allocation</i>	<i>Process</i>
<i>Finance</i>	FTE	FTE allocation process as above.
<i>HR</i>	FTE	FTE allocation process as above.
<i>General Counsel</i>	FTE	FTE allocation process as above.
<i>Strategy & Regulation</i>	Regulation costs	Manpower costs are allocated on the basis of 1/9 th to retail and remaining 8/9 th are allocated to water and waste water based on a 50:50 split for each price control so as not to favour one wholesale price control over another. A transactional review is carried out for non-manpower costs to identify any costs that can be directly allocated to price controls. The balance is then also split 1/9 th retail and 8/9 th water and waste water. Water and waste water are allocated equally to avoid bias between price controls.
<i>Health & Safety</i>	Management estimate	Health & Safety activities are allocated between wholesale and retail. Standard Dams and Assurance and Resilience activities are allocated to Water.

<i>Technology</i>	Direct cost attribution & FTE	IS support costs are attributed to specific IS systems which are then allocated to business areas, wholesale, retail or general and support using headcount numbers. Wholesale is further allocated between water and waste water based on wholesale headcount. IS costs which are across the whole business e.g. SAP costs are General and support IS costs are allocated across water, waste water and retail in proportion to the value of costs that are already assigned to these areas.
<i>Packsaddle Head Office costs</i>	Occupancy	The Packsaddle office site is shared by wholesale and retail and allocated by number of heads occupying the building. A SAP HR report with employee location and cost centre coding provides the data source. Costs are allocated based on the occupation of the sites and the employees' cost centre price allocation to establish the price control usage of the site.
<i>Portfolio Management</i>	Estate Legal ownership	Allocate the portfolio management cost of looking after the title ownership of the estate. This is achieved by splitting the Hafren Dyfrdwy title ownership by price control. This is after recharging the cost of collecting and managing rental income.
<i>Property operational costs</i>	Transactional analysis	The Property operational costs are allocated based on causality. A transactional analysis of the operational site costs cost centre is performed to identify spend by site and therefore the price control business unit.
<i>Group Commercial</i>	Time spent	Timesheet templates completed by Group Commercial team members.
<i>Stores Management</i>	Volume of stores issues	Volume of store issues multiplied by price control allocation of receiving cost centres.

G&S costs are allocated between household and non-household based on FTE.

A summary of the G&S allocation by support function is outlined below:

Support area	Water Resource	Water Network +	Wastewater Network +	Bioresource	Retail HH	Retail NHH	Total
<i>Directors</i>	11.3%	58.1%	19.8%	0.0%	8.9%	1.9%	100.0%
<i>Human Resources</i>	11.6%	54.6%	24.2%	0.0%	8.1%	1.5%	100.0%
<i>General Counsel</i>	11.7%	54.6%	24.2%	0.0%	8.1%	1.5%	100.0%
<i>Property</i>	18.2%	54.2%	24.2%	0.2%	0.0%	3.1%	100.0%
<i>Finance & Assurance</i>	11.4%	53.3%	23.6%	0.0%	9.7%	2.0%	100.0%
<i>Strategy & Regulation</i>	11.1%	33.3%	29.6%	14.8%	10.5%	0.7%	100.0%
<i>Chief Engineer</i>	25.0%	46.0%	21.0%	0.0%	6.0%	2.0%	100.0%

12. Capital expenditure process

Capital investment framework ('CIF')

The Company's capital investment framework ('CIF') manages large capital programmes. Capital projects go through a formal approval process as follows:

<i>Owner(s)</i>	<i>Process / activity</i>
<i>Project Manager</i>	Submit a business case template (project/ application) outlining the operating and capital expenditure.
<i>Programme Board</i>	Discuss and review project with the Finance Analyst teams.
<i>Investment Governance Analyst</i>	<p>Scrutinise project applications and assess whether operating costs and capital expenditure have been allocated correctly. In the event that they disagree with the proposed accounting treatment the project manager is advised accordingly.</p> <p>In certain circumstances, the guidance issued by the Analyst Team may be contested by the project team. In such cases the proposal is referred to Group Finance who after referring to the appropriate International Financial Reporting Standard or Regulatory Accounting Guidance, provide a defining judgment on the issue.</p>
<i>Group Finance</i>	Issue a guidance note to aid business users in the preparation of their capital investment proposals. This tends to occur for more complex areas where the applicable accounting principles, as defined in the capital expenditure accounting policy, are less easily understood by non-finance professionals.

Labour, pensions and overhead absorption rates ("Burdening")

This is a process that enables the recovery of costs from departments (primarily Support) whose activities are indirectly linked to the capital programme. The burdening process calculates these costs and allocates them to capital accordingly.

The overhead burden rate is calculated as follows:

Total allowable staff and support function costs to be recovered divided by the gross annual investment programme expressed as a percentage.

The burden rate is refreshed at half year and then finalised at the year end.

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