

Upstream services
methodology statement 2013/14

WATER

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The purpose of this document is to outline the way we allocate costs between the different services of the wholesale business units.

The business units and services referred to in this document are:

Business unit	Service
Water resources	Abstraction licence Raw water abstraction
Treated water distribution	Trunk distribution Local distribution
Raw water distribution	Raw water transport Raw water storage
Water treatment	Water treatment

Costs for the water treatment business unit are not sub-divided. As such the costs reported in the upstream services table are the same as in the wholesale accounting separation table.

The allocations of total operating expenditure, Infrastructure Renewals Charge (IRC) and Current Cost Depreciation charge (CCD) are presented in the upstream services table.

The following definitions have been applied to underpin cost allocations between the services:

Abstraction licence	Costs directly coded in the general ledger cost code for abstraction licences.
Raw water abstraction	All other costs relating to water resources.
Raw water transport	Cost of pumping water from Longham to Alderney, and repairs to raw water mains.
Trunk distribution	Trunk mains repair costs and site costs based on district main areas (DMA).
Local distribution	Remaining distribution costs.

Cost allocation principles applied

This methodology has been prepared in accordance with Ofwat's cost allocation principles outline in 'Regulatory accounting guideline 4.04 – Guideline for the definitions for the regulatory accounts tables':

Transparency

Our accounting system has been set up with the Ofwat reporting requirements in mind. This enables us to more easily identify costs which need to be allocated. These cost allocations are then made within the finance system, according to cost drivers explained below (see Operating expenditure allocations).

Causality

Costs are allocated to those activities and services that incur the costs. Costs are attributed to the cost centre that generates the cost. Cost centres refer to sites, departments and activities, allowing for a detailed level of costing.

Non-discrimination

We allocate costs to the business units using the most appropriate drivers. Our internal transfer charges are consistent across all business units. Where external parties are charged at cost, the same labour rates are used.

Objectivity

Costs and revenue are allocated to the "owning" cost centre, with no regard to how such an allocation might or might not affect a business unit or service.

Consistency

The vast majority of our costs are treated consistently from year to year. However, should guidance change or we identify a way to improve our accuracy in reporting, we then make changes. Any such changes, where significant, are commented upon.

Operating expenditure allocations

Total operating expenditure is allocated between the services in the upstream services table as follows:

Abstraction licence	Costs are directly coded with a specific general ledger code.
Raw water abstraction	Costs are directly coded to specific cost centres. This includes pumping costs from Matchams to our site at Longham.
Trunk distribution	Specific jobs and cost centres define the trunk mains repair costs and site costs, and are directly allocated. General and support (G&S) costs are pro-rated on the ratio of direct treated water distribution costs allocated between trunk distribution and local distribution.
Local distribution	This is made up of the remaining distribution costs (which are not allocated to trunk distribution above). G&S costs are pro-rated on the ratio of direct treated water distribution costs allocated between trunk distribution and local distribution.
Raw water transport	Costs are directly coded to cost centres; however Longham is the only site that transports raw water. A management estimate is used to allocate pumping costs between raw water transport and raw water storage. We review the power consumption each year to make sure the correct calculation is being used. G&S costs are pro-rated based on the ratio of Longham power costs allocated between raw water transport and raw water storage.
Raw water storage	This is made up of the remaining raw water distribution costs (which are not allocated to raw water transport above).

Infrastructure Renewal Charge (IRC) allocation

We have a specific general ledger code to identify the IRC. Using the 2007/08 GMEA valuation exercise as a starting point, our Asset Manager calculates the allocation percentage that we then apply.

Current Cost Depreciation (CCD) allocation

All assets have a primary site attached to them, which is consistent with operational costs. This simplifies the allocation of CCD.

There are no assets that relate to the abstraction licence service, therefore there is no CCD.

All water resources' CCD relates to raw water abstraction.

Individual sites belonging to trunk treated water distribution are identified. The related CCD on assets held by these sites is then directly allocated. Trunk distribution also has a pro-rated share of the CCD relating to treated water distribution G&S assets. The CCD on these assets is pro-rated between trunk and local distribution in line with the allocation of G&S operating expenditure. Mains themselves are not depreciated.

Local distribution CCD is the balance of treated water distribution CCD which is not allocated to trunk distribution.

Raw water transport CCD is derived from CCD relating to specific assets involved with raw water transport. These assets involve pumping water to our Alderney site. Raw water transport also has a pro-rated share of the CCD relating to raw water transport G&S assets. The CCD on these assets is pro-rated between raw water transport and raw water storage in line with the allocation of G&S operating expenditure.

Raw water storage CCD is the balance of raw water distribution CCD which is not allocated to raw water transport.

Significant cost movements in 2013-14

Business units / service	Table category	2012-13 (£m)	2013-14 (£m)	Commentary
Raw water abstraction	Total operating expenditure	1.224	1.409	Power costs have significantly increased due to the need to pump water from a more distant resource in order to maintain water quality.
Treated water distribution	Total operating expenditure	8.046	8.133	Total spending in treated water distribution has not changed significantly, but the split between trunk and local has changed. This is to be expected, see reason below.
Trunk treated water distribution	Total operating expenditure	2.492	3.093	Repair costs for trunk mains and distribution mains will vary year on year, depending on which particular pipes are most urgently in need of repair. This is largely unforeseeable and as such we expect there to be volatility between costs incurred by trunk and distribution mains repairs. As additional large diameter mains required attention this year, trunk distribution spend has significantly increased.
Local treated water distribution	Total operating expenditure	5.554	5.040	Repairs to the pipe network are prioritised to optimise customer service. In 2013/14 the trunk mains were the priority and as such the distribution mains spend was reduced.
Raw water distribution	CCD	0.479	0.556	This increase is due to additional assets acquired in the year.
Raw water storage	CCD	0.416	0.497	This increase is due to additional assets acquired in the year.
Local treated water distribution	CCD	1.018	1.259	This increase is due to additional assets acquired in the year.