

# ACCOUNTING SEPARATION METHODOLOGY

YEAR ENDED 31 MARCH 2021



# Accounting Separation 2020/21





## 1 OPERATIONAL EXPENDITURE

### Table 4D/4F

#### 1.1 BACKGROUND AND PURPOSE

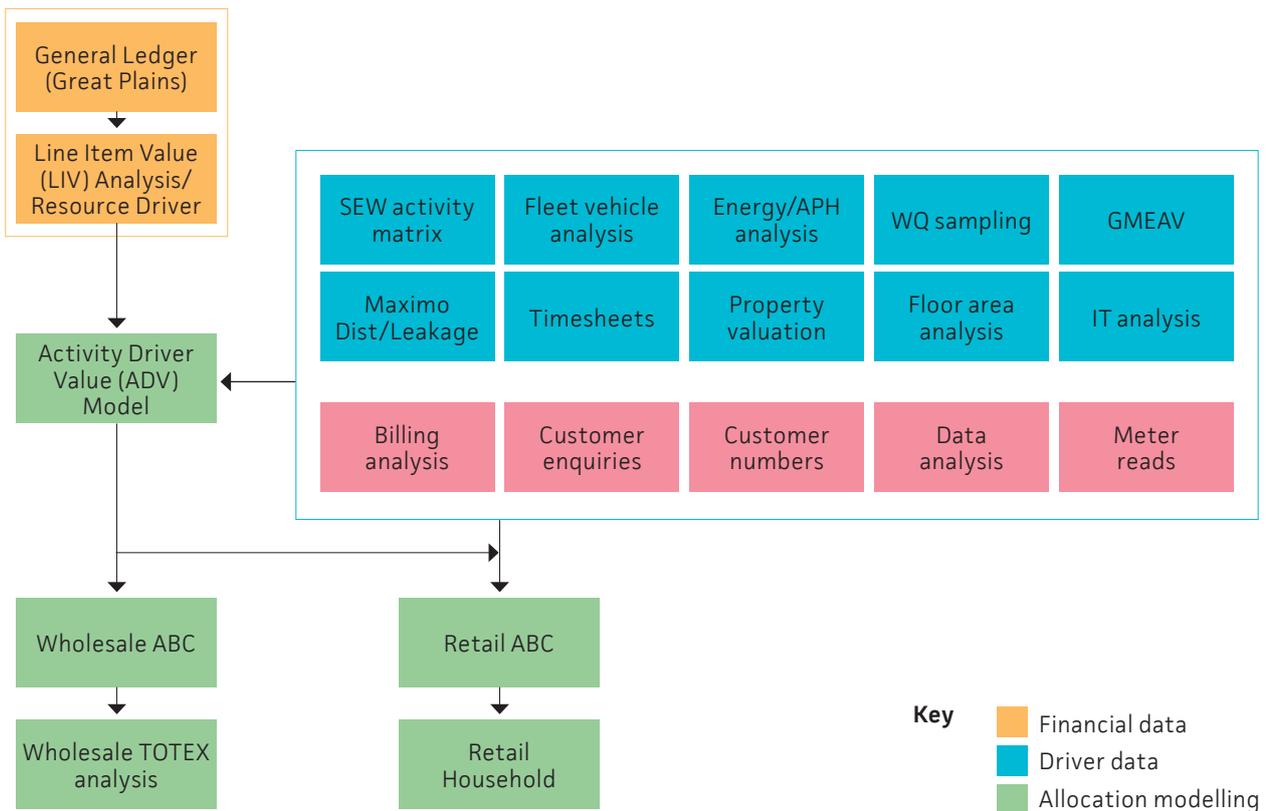
The purpose of this methodology statement is to illustrate the process and allocation procedures undertaken to complete the operating costs.

**1 OPERATIONAL EXPENDITURE** continued

**1.2 OVERALL TABLE METHODOLOGY**

**Overview / Data and System Integration**

An outline of system integration to produce the operating expenditure accounting separation tables is given below.



As the above diagram outlines, inputs are either cost or driver related. All costs come from a single source, the general ledger (Great Plains), and are exactly replicated within the cost allocation model. The general ledger exports an operating expenditure extract. This is converted into a Line Item Value (LIV) analysis and contains the following information:

- account cost code
- account description
- responsibility centre number
- responsibility centre description
- sum of period balance
- stat adjustments
- adjusted sum of period balance

The LIV analysis includes ninety-five responsibility centres and this level of detail provides the platform of ensuring costs are allocated to the correct business unit. The LIV is analysed and for each combination of responsibility centre and account cost code a resource driver is assigned. Cost aggregated against these resource drivers are later allocated to business unit, and activity line, by use of activity driver value (ADV) allocations.

## 1 OPERATIONAL EXPENDITURE continued

Given this level of detail combination of responsibility centre and account cost code can be specifically attributed to one business unit, and potentially to one activity line (i.e. the resource driver allocation would have a value of 100 per cent to one activity line). An example of this includes doubtful debt, which is a single account in the General Ledger, and a single line within the retail services table. Chemicals are another example of this allocation method, since these costs can be directly apportioned to the business unit "water treatment". Additionally, the detailed level of the LIV can also mean direct coding of labour resource to business unit.

Where direct coding is not possible, the resource driver assigned can have multiple values to allocate cost across more than one business unit and/or activity line. In all cases the resource driver will always total 100 per cent to ensure all cost is allocated. When determining resource driver values appropriate driver data is sought to ensure robust allocation.

### Driver Methodology

#### *South East Water Activity Assessment*

The purpose of this assessment is to understand every South East Water personnel resource purpose in the company. The company is at a size which currently makes this a feasible annual exercise and provides a robust analysis of activity across all business units and activity. The regulation and strategy team undertake an assessment with each responsibility centre manager and each member of staff is reviewed to understand their activity across the subject period. As outlined above a significant number of resources have a dedicated purpose to one business unit and are therefore directly assigned (e.g. billing agent). Where resources are deemed to cross business units (or activities) then their time is appropriately allocated. Where this is the case we seek robust driver data (e.g. works management capture systems). Where direct driver data is not available then time is assessed by the responsibility centre manager.

#### *Maximo Distribution / Leakage*

Maximo is our works management system used to record activity spent within our distribution network. For each activity there is a specific jobplan. We have mapped each jobplan to a business unit, and we are therefore able to aggregate hours of resource time spent to each business unit which is used to allocate associated cost. We review the jobplan mapping assessment annually to ensure the allocation remains appropriate and includes any additions of any new jobplans created. Specifically Maximo distribution/leakage provides an assessment of resource time spent upon the treated water distribution network and conducting investigatory field visits to (retail) customers.

#### *Energy kWh Analysis*

Given the large proportion of cost attributed to energy the company invests a significant amount of time to energy management and optimisation. The benefit of this analysis provides a visibility of energy across the business units. We are constrained by the use of single point metering. The majority of key energy sites support the water resource function through to the high-lift pumps of treated water distribution. Via the cost-assessment approach the industry has made improvement with regard to average pumping head classification across the functions of accounting separation. In the absence of sub-metering, average pumping head provides the best proxy use of energy across the management functions, and we have therefore aligned our cost to this allocation measure. We believe this provides the best consistency for industry comparison.

#### *Water Quality Sampling*

To assist with the allocation of water quality activity we use sampling numbers undertaken across the business units. Given the size and geography of the South East Water region we do not have a significant raw water network (i.e. the majority of abstraction and treatment is undertaken within a single site boundary). As such we assume no WQ samples are undertaken within a raw water network (i.e. samples are taken at either abstraction or within the treatment process).

## 1 OPERATIONAL EXPENDITURE continued

### *Bulk Supplies*

We receive both treated and untreated bulk supplies. We are aware of the RAG2 guidance to allocate bulk supply treatment across the relevant business functions. However we do not receive an allocated cost from either of our bulk suppliers (Affinity Water and Southern Water), and we are unable to establish a suitable allocation from their previous APRs. We are also concerned that using previous APRs would not be a suitable proxy of allocated cost since received volumes varies from scheme to scheme. We have therefore retained the previous allocation – i.e. untreated bulk supplies allocated to water resources; and treated bulk supplies allocated to water treatment. We are seeking collaboration from our bulk suppliers to improve their invoiced cost allocation for future periods.

### *IT Analysis*

Analysis of key IT metrics are used to assist with the allocation of IT costs across business units and includes IT asset numbers and analysis of software licence costs.

### *GMEAV*

The PR14 assessment of GMEAV has been used to allocate appropriate cost relating cumulo rates. We have updated the apportionment to take account of assets switching from water resources to water network+ as per the revised regulatory accounting guidance in response to the pending water resources market. This has resulted in two surface reservoirs switching from water resources to raw water storage (network+).

### *Floor Area*

Floor area has been used as an appropriate driver to allocate cost at office locations, for example local authority rates.

### *Fleet Vehicles*

Numbers of direct vehicles is used to allocate associated cost (e.g. insurance).

### **Pension Deficit Recovery Payments**

As per the final determination all pension deficit recovery payments are allocated to the water resource and water network+ price controls using the following allocations:

- Water Resources – 14%
- Water Network+ – 86%

The final determination guidance therefore means we no longer allocate the pension deficit recovery payment to the retail household price control. For the business units contained within network+ we have pro-rated according to allocations for 2019/20.

## 1.3 WHOLESALE

### **Methodology**

The overall methodology is consistently applied to both wholesale and retail, however outlined below is an overview of wholesale methodology specific to the wholesale function, including water resources, raw water distribution, water treatment, and treated water distribution.

The following table provides a brief methodology view of how operating costs are allocated, initially to table 4J, before being aggregated into table 4D.

## 1 OPERATIONAL EXPENDITURE continued

### Operating expenditure

**Table 4J**

4J.1	Power	Energy at supply point is analysed to assess their appropriate business unit. Where energy points cover multiple business units then average pumping head is used to allocate cost appropriately.
4J.2	Income treated as negative expenditure	South East Water undertake an element of generator exporting to assist with grid balancing initiatives.
4J.3	Bulk supply imports	Bulk supplies are a direct cost item at responsibility centre level and are therefore directly apportioned to either the water resources or water treatment function – since South East Water receive both non-potable and potable supplies from neighbouring companies.
4J.6	Other operating expenditure	Included within this line are (direct) employment, hired and contracted, materials and consumables (e.g. chemicals), plus all general and support function costs. Pension deficit recovery payments are excluded from employment costs within this line and reported as cash expenditure in 4D.16.
4J.7	Local authority rates	Cumulo rates are apportioned according to our GMEAV allocations, whilst local authority rates are apportioned according to floor area.
4J.9	Service charges	The majority of service charges relate to EA abstraction licences and are therefore directly attributable to the water resource function. A smaller element of expenditure relates to discharge consents, and is directly attributable to the water treatment function.
4J.11/12	Traffic Management Act / Lane rental schemes	By interrogation of invoices we are able to identify expenditure in the period for both traffic management act and lane rental schemes. All highway activity is allocated to the treated water distribution business unit.

**Table 4D**

4D.1	Base operating expenditure	Calculated sum from base operating costs in table 4J.
4D.2	Enhancement operating expenditure	Additional leakage operating costs have been identified as enhancement – this includes an increase in free leak repair activity. We calculated the enhancement as the variance between 2019/20 and 2020/21 costs for the leakage optimisation cost centre.
4D.3	Developer service operating expenditure	There is no developer service operating expenditure – all project work is capitalised. The only developer service operating expenditure is in relation to admin and queries and is allocated to the non-household price control (2C.5)

### Wholesale Cost Variances

The wholesale cost allocation tables for 2020/21 have been disaggregated to provide more detail, and therefore cost comparison is not possible across all lines. However, the following lines are retained along with their percentage movement:

- Table 4J Line 1 – Power – 7% increase / 1% of total opex
- Table 4J Line 2 – Income treated as negative expenditure – new cost
- Table 4J Line 3 – Bulk supply – 10% increase / 1% of total opex
- Table 4J Line 7 – Local authority rates and cumulo rates – 1% increase / 0% of total opex
- Table 4J Line 9 – Abstraction charges / discharge consents – 0% / 0% of total opex
- Table 4D Line 5 – Third party services – 16% decrease / 0% of total opex

Previous 2019/20 values have been adjusted for inflation (CPIH) to ensure variances are calculated on a real price basis. Trigger levels for comment regarding significant change includes line fluctuation exceeding 2 per cent of total operating expenditure (either wholesale or retail expenditure), and also individual line cost which has changed by more than 30 per cent of the prior year figure. As such the only line required for comment is income treated as negative expenditure. This is brand new cost for 2020/21 reflecting grid balancing charges at one of our sites, totalling £59k.

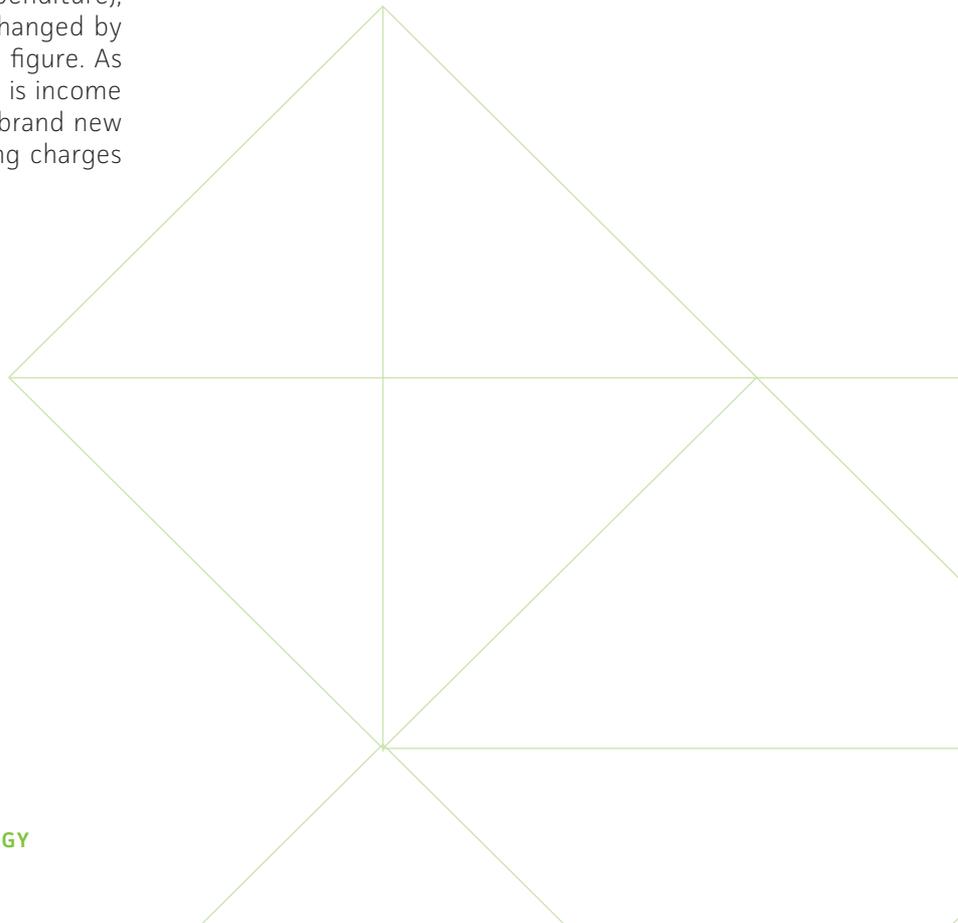
### 1.4 HOUSEHOLD RETAIL

#### Methodology

We continue to internally report customer services to a greater level of detail than required from table 2C, matching instead the guidance set out in RAG 2.08.

The majority of household retail expenditure is directly calculated via direct cost centres that are solely for the household price control. However, an element of household cost is derived by cost allocation. For example, wholesale distribution cost centres undertake an element of investigatory visits, and meter reading at customer properties. For this example we are able to allocate cost accurately via use of appropriate activity analysis recorded in Maximo against relevant jobplans. A number of support services also allocate cost between the various prices controls, and are allocated appropriately.

The following table confirms the level of detail, and how we aggregate to table 2C.



## 1 OPERATIONAL EXPENDITURE continued

Activity Heading	Table 2C mapping	Comment
Billing	2C.1 Customer services	Costs derived directly from retail HH cost centre
Payment handling	2C.1 Customer services	Costs derived directly from retail HH cost centre, with some allocation from the finance cost centre who perform the payment handling function
Charitable trust donations	2C.6 Other operating expenditure	Costs derived directly from retail HH cost centre
Vulnerable customers schemes	2C.1 Customer services	Costs derived directly from retail HH cost centre, with some allocation from the Customer Insight team
Non-network customer queries	2C.1 Customer services	Costs derived directly from retail HH cost centre
Network customer queries	2C.1 Customer services	Costs derived directly from retail HH cost centre
Investigatory visits	2C.1 Customer services	Costs allocated from wholesale distribution team
Other customer services	2C.1 Customer services	Costs derived directly from retail HH cost centre
Debt management	2C.2 Debt management	Costs derived directly from retail HH cost centre
Doubtful debt	2C.3 Debt management	Costs derived directly from retail HH cost centre
Meter reading	2C.4 Meter reading	Costs derived directly from retail HH cost centre
Demand-side water efficiency	2C.6 Other operating expenditure	Costs allocated from the water resource and communication teams
Customer side leaks	2C.6 Other operating expenditure	Costs allocated from wholesale distribution team
Other direct costs	2C.6 Other operating expenditure	Costs derived directly from retail HH cost centre
IT general & support	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Vehicle general & support	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Finance etc general & support	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Executive directors	2C.6 Other operating expenditure	Directorate activity assessment
Facilities etc general & support	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Other general & support	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Other business activities	2C.6 Other operating expenditure	Costs allocated from appropriate support service cost centres
Local authority rates	2C.7 Local authority rates	Central Gov't rates – GMEAV Local Auth' rates – Floor space

## 1 OPERATIONAL EXPENDITURE continued

### Household Cost Variances

Percentage variances from the previous year regarding household costs are outlined below:

Description	£m	line increase (%)	% increase of total opex
Customer services	6.8	8	3
Debt management	0.7	109	2
Doubtful debts	3.5	(21)	(5)
Meter reading	0.9	7	-
Other operating expenditure	5.9	(7)	(3)
Local authority rates & cumulo	0.3	1	-

Previous 2019/20 values have not been adjusted for inflation, hence percentage variances are calculated on a nominal price basis. Trigger levels for comment regarding significant change includes line fluctuation exceeding 2 per cent of total operating expenditure (either wholesale or retail expenditure), and also individual line cost which has changed by more than 30 per cent of the prior year figure.

Reasons for triggered variances are outlined below:

- Customer services cost recorded a 3 per cent of total household opex increase for the period – this is the consequence of accumulative 1 per cent cost increases for billing, non-network enquiries and complaints, network enquiries and complaints, and investigatory visits
- Debt management costs increased by 109 per cent in the period – a consequence of recoveries significantly being reduced in 2020/21 due to Covid-19 restrictions, and were compounded by a review by the debt team of legacy debts, resulting in the write-off of a number of ‘time expired’ litigation debts
- The doubtful debt decreased by 21 per cent in the period. The decrease is a consequence of the previous year increase in doubtful debt cost – a reflection of old debt not being collected. The doubtful debt value is agreed in coordination with our financial auditors

Other operating expenditure decreased by 3 per cent of total household opex in the period – a consequence of the pension deficit payment no longer being allocated to household as per final determination.

### 1.5 NON-HOUSEHOLD RETAIL

The only operating cost allocated to non-household are services to developer costs (2C.5). These are costs in relation to admin and response to developer queries.

## 2 CAPITAL EXPENDITURE

### 2.1 BACKGROUND AND PURPOSE

The purpose of this methodology statement is to illustrate the process and allocation procedures undertaken in order to calculate the capital costs necessary to complete tables; 2B (totex analysis for wholesale), 2C (totex analysis for retail), 2D (historic cost analysis of tangible fixed assets for the wholesale and retail business), 2J (infrastructure network reinforcement costs), 2K (infrastructure charges reconciliation), 2O (historic cost analysis of intangible assets for the wholesale and retail business), 4D (wholesale totex analysis), 4F (major project costs for wholesale), 4J (base expenditure for wholesale), 4L (enhancement expenditure for wholesale), 4N (developer services price control expenditure for wholesale), 4P (developer services non-price control expenditure for wholesale).

## 2 CAPITAL EXPENDITURE continued

The Regulatory Accounting Guidelines (“RAGs”) require the company to look at each individual asset and determine to which price control(s) and business unit(s), as defined by Ofwat, they belong by reference to the assets’ use. The purpose of the fixed asset accounting separation tables within the Annual Performance Report (“APR”), as stated above, are to split the entire asset register of South East Water Limited (“SEWL”) into the applicable groupings as shown in the table below:

Water Resources		Water Network+					
Abstraction Licences	Raw Water Abstraction	Raw Water Transport	Raw Water Storage	Water Treatment	Treated Water Distribution	Retail Household	Retail Non-Household

### 2.2 OVERALL TABLE METHODOLOGY

As prescribed by Ofwat, the Regulatory Accounts for the finance year 2020/21 have been prepared on an historic cost basis.

The change from current cost accounting to historic cost accounting occurred in the 2015/16 finance year. At which stage the allocation of opening balances for cost and depreciation to business units was based pro rata on the current cost values from the previous year.

With the introduction of water resources as a separate price control in 2020/21, and in keeping with the regulatory requirement to report the allocation of the company’s asset base based on the asset’s principle use, as defined in the RAGs, we have seen a shift in the allocation of wholesale assets in table 2D. We have also taken this opportunity during the finance year to complete a comprehensive review of our fixed assets accounting system to identify any potential historic miss-allocation between the aforementioned price controls and business units.

The re-allocation as a result of this change has been shown within the adjustments lines on both cost and depreciation within table 2D and is detailed further in section 2.8 of this accounting methodology statement below.

The following describes the methodology and procedures used in preparing and adjusting the data to be entered into the tables relating to fixed assets within the annual performance report. Also included below are explanations of any material movements or variances in cost which have arisen in the year.

The primary data source for the fixed asset tables is the company’s fixed assets accounting system, including the register of assets in use and work in progress, where assets currently under construction are recorded. The majority of our asset values are brought forward from the prior year.

At the end of the finance year, data is downloaded from our fixed assets accounting system detailing the transactions that have occurred during the year. These downloads are then converted into excel files, which in turn are used in order to calculate the figures to be entered into the annual performance report.

These calculation files have been audited by our reporter, Atkins, to provide assurance with our regulatory compliance.

### 2.3 ADDITIONS

Additions form a major part of both the wholesale totex analysed in table 4D and the historic cost analysis of fixed assets completed in table 2D of the APR. Additions are accruals based and reflect the total capital expenditure of the company over the past year.

As mentioned earlier, a download is run from the company’s fixed assets accounting system which encompasses the total capital expenditure over the year. This data is then analysed in order to allocate the expenditure to the applicable price control and business unit. Additionally, the nature of the capital project being completed is identified, enabling capital expenditure to be split between base, enhancement and developer services and infrastructure or non-infrastructure works.

## 2 CAPITAL EXPENDITURE continued

In order to allocate capital expenditure accurately, the company builds the records held within its fixed asset accounting system based upon Capital Expenditure Requests (“CERs”). The CERs form the basis on which capital expenditure is allocated. For each capital project, the project manager is required to describe in detail the nature of the expenditure and the correct regulatory allocation, including business unit, asset type and asset life. This information is then sense checked by the Capital Programme Management team and Finance department before being added to the company’s fixed asset records, ensuring capital expenditure is recorded against the appropriate criteria.

In addition to the checks completed on recording capital projects in the company’s fixed asset accounting records, the download is reviewed by the Capital Programme Management team, who use their expertise and knowledge of the capital works to ensure capital expenditure is allocated correctly. In any instances where errors are found within the download file, they are corrected manually within the file and appropriate adjustments are later made to the records held within the company’s fixed asset accounting system.

### Determining Business Unit

During the authorisation process of capital projects, project managers are required to identify on the CERs which business unit or units the asset being constructed will be used by. All future expenditure incurred in the construction of the asset is then allocated to the business unit(s) as specified by the project manager.

As an additional part of the authorisation process, the Capital Programme Management team and Finance department review each CER in order to ensure their accuracy before being recorded in the company’s fixed asset accounting system. Project data recorded within the fixed asset accounting system is periodically reviewed by both the Finance department and the Capital Programme Management team to ensure records are correct and remain up to date as part of the company’s accounting records, minimising the risk of miss reporting capital expenditure.

Unlike assets that are used by a single price control and are therefore allocated to a single business unit within the company’s fixed asset register. Where an asset is expected to be used by more than one

business unit, it is recorded in the company’s fixed asset accounting system against the business unit identified as being the principle function for which the asset will be used as stated on the relevant CER. A trigger is applied against these assets within the accounting system in order to differentiate it from assets that are expected to be used by one single price control. Doing so enables the Finance department to identify projects within the system download files, where it is necessary for the cost to be recharged across multiple business units. In this instance the data included within the download files is cross referenced to the CER in order to then recharge the cost of the asset between the various business units as applicable, any such amendments are then reviewed by the Capital Programme Management team to ensure their accuracy.

Expenditure on projects designated as general and support is allocated to business units based on the same cost drivers as used in the operating cost tables and described above. Each project is assigned to a specific cost driver dependant on the asset generated from completing the project, for example, expenditure incurred in acquiring new IT software or hardware would be based on the IT cost driver.

### Determining Asset Type

The allocation of capital expenditure between infrastructure, operations and other assets is based upon the information provided by the project managers when completing the CERs. If the project involves the construction of an asset which covers more than one asset type, the costs are split by asset type based on the percentage allocated to each asset type by the project manager. Again, this information would be sense checked by the Capital Programme Management team and Finance department as part of the approval process in order to identify any discrepancies prior to being recorded in the company’s fixed asset accounting system.

When completing the CER, the project manager must select whether the nature of the asset relates to infrastructure, operations or other along with the expected asset life depending on the asset being constructed. This selection is prescriptive based upon the category of asset being constructed in order to help ensure the accuracy of data provided by project managers in relation to the nature of the asset and its expected life. The table to be completed within the CER by the project manager is shown overleaf.

## 2 CAPITAL EXPENDITURE continued

	Asset Life	Category	Cost (£k)	% Split
INFRA	0	Surface (Impounding Reservoirs)		
INFRA	60	Meter Boxes		
INFRA	100	Mains		
OPS	Non-Depreciating	Land		
OPS	0 – 10	Fixed Plant (Light)		
OPS	7	Mobile Plant		
OPS	10	Telemetry Equipment		
OPS	15 – 20	Fixed Plant (Light)		
OPS	20	Meters		
OPS	21 – 30	Fixed Plant (Light)		
OPS	35 – 60	Fixed Plant (Heavy)		
OPS	60	Wells & Boreholes		
OPS	80	Building-Non		
OPS	80	Service Reservoirs & Water Towers		
OTHER	1 – 5	Consultants		
OTHER	3 – 5	Computer Hardware		
OTHER	3 – 7	Computer Software		
OTHER	4	Vehicles		
OTHER	5	Office Equipment		
OTHER	5	Furniture & Fittings		
OTHER	6	Lab Equipment		

### Total

### Determining Asset Enhancement or Maintenance

When completing a CER, the project manager must detail as to whether the project in question relates to the construction of a new asset, the enhancement of a current asset, maintenance of a current asset or the reinforcement of a current asset as the result of new connections or developments. Though in the majority of instances assets would fall into one single category, if the project relates to the construction of an asset which falls into more than one of the above categories, the costs are split over the different categories based upon the percentage split provided by the project manager.

The information provided by the project manager would be sense checked by the Capital Programme Management team and Finance department as part of the approval process to ensure the accuracy of the CER before the project is recorded in the company's fixed asset accounting system. The data recorded in the fixed asset accounting system is periodically sense checked by the Capital Programme Management team in order to ensure its accuracy, feeding back any issues they have to the Finance department who are then able to make any changes to the accounting system as necessary.

## 2 CAPITAL EXPENDITURE continued

The table to be completed by the project manager as part of the CER is shown below.

	Infra Assets %	Non-Infra Assets %	Total %
<b>Additions – New Assets (Enhanced)</b>			
Drinking Water Quality inc. SEMD			
Enhanced Service Levels			
Supply Demand Balance			
<b>Base Service Provision</b>			
Maintenance Non-Infrastructure			
Maintenance Infrastructure			
<b>Infrastructure Network Reinforcement (New Connections/Developments)</b>			
Distribution & Trunk Mains			
Pumping & Storage Facilities			
Other			

### 2.4 DISPOSALS

Disposals reported in the historic cost analysis of fixed assets table (2D) in the annual performance report represent both the fixed assets sold and those no longer used by the company. The assets disposed of by the business in the year are deducted from the asset balances of business units based upon the value of costs and depreciation removed from the company's fixed asset accounting system.

In order to calculate this a download is run from the company's fixed asset register, detailing the assets disposed of during the year along with the cost of acquisition and the life to date depreciation. This download is then analysed in order to split the cost and depreciation of disposals between the various business units.

The basis on which disposals are allocated between the different business units varies dependant on the type of asset being disposed. For instance, mains abandonments are allocated wholly to the treated water distribution business unit, whereas disposals of vehicles, IT equipment and office furniture are allocated to the relevant business units on a cost driver basis. Other types of assets are then allocated in line with the treatment of similar assets in the additions analysis.

This process allows the company to accurately show the impact of disposals on the fixed assets held by the business, as reported in table 2D of the APR file.

### 2.5 RETAIL TABLE ASSETS

A valuation of the company's assets was carried out in 2008 on the adoption of International Financial Reporting Standards and was used as our opening balance for cost and depreciation under current cost accounting rules. This was analysed in order to segregate costs and depreciation between relevant business units.

Prior to 2008 records of the allocation of projects between price controls and business units were not maintained in the company's accounting records, rather spreadsheets were rolled forward year on year to provide the required asset allocations. Since the change from current cost accounting to historic cost accounting, the allocation of the opening balance between wholesale and retail was based pro rata on the current cost values brought forward from the previous year, with the values being updated each year for movements, including inflation.

As mentioned above, during the current finance year we completed a comprehensive review of our fixed asset register in order to accurately allocate all assets between the price controls and business units. This analysis has enabled the effective allocation of each individual asset and therefore eliminated the need to allocate based on the current cost values brought forward.

## 2 CAPITAL EXPENDITURE continued

The impact, as a result of this review, is reported within the adjustments lines for both cost and depreciation within table 2D and is detailed further in section 2.8 below.

### 2.6 HCA DEPRECIATION

For the household retail cost analysis completed in table 2C in the annual performance report, depreciation charged for the year calculated on an historic cost accounting basis is split between fixed assets acquired before or after the 1 April 2015.

In order to split the depreciation charged for the reporting year a download is produced from the company's fixed assets accounting system which encompasses the total depreciation charged in the year on each asset along with the year in which the asset was acquired. From the total depreciation charged in the year, per our fixed asset register, we then deduct the depreciation of capitalised interest which is apportioned between the price controls based on the split of the depreciation charge to arrive at the total depreciation charge in accordance with the regulatory guidelines.

### 2.7 CONTRIBUTIONS

Following the company's adoption of IFRS15 in April 2018, contributions are initially taken to the balance sheet as a liability on receipt and then released in full as income to the income statement once works to which the contributions relate have been completed.

The company's approach to recording contributions in the regulatory accounts differs from that of the financial accounts. As the economic life of the relevant asset is often 100 years, it was decided that it was more appropriate for the regulatory accounts for contributions to be recognised and offset against totex in the year in which they are received.

### 2.8 IN YEAR ANALYSIS OF THE FIXED ASSET REGISTER

As mentioned briefly above, during the 2020/21 finance year we completed an all-inclusive review of the company's fixed asset register in order to allocate each individual asset between the price controls and business units in order to report the split of the company's asset base more accurately.

In order to complete this review, a download was produced from the company's fixed asset register which incorporated each asset currently held along with the regulatory allocations which had been previously mapped.

A number of assets required mapping to appropriate price controls and business units. In order to ensure the accuracy of these allocations, the Finance department together with the Capital Programme Management team assessed each asset where data was absent on the fixed asset register and allocated them in accordance with a mix of historic CERs, cost allocations and where such data was not available, in line with how similar assets are allocated.

While completing this process, the opportunity was taken to also review the allocations of assets where the regulatory treatment was included on the company's fixed asset register to ensure the accuracy of all data held.

Following this review, we are able to more accurately allocate the company's asset base across the price controls and business units providing a better representation of the mix of the company's assets.

This review, coupled with the introduction in 2020/21 of water resources as a separate price control, has had the following impact on the allocation of the company's fixed assets in terms of cost, life time depreciation and net book value at 31 March 2021 as reported within the adjustments lines in table 2D of the APR.

## 2 CAPITAL EXPENDITURE continued

Description	Cost £m	Depreciation £m	Net Book Value £m
Water Resources	29.042	14.158	43.200
Water Network+	(37.376)	(6.268)	(43.644)
Retail Household	9.997	(7.947)	2.050
Retail Non-Household	(1.663)	0.057	(1.606)
<b>Total</b>	-	-	-

These allocation changes have resulted in closing balances on cost, depreciation and net book value at 31 March 2021 as shown in table 2D of:

Description	Cost £m	Life Time Depreciation £m	Net Book Value £m
Water Resources	167.268	(33.768)	133.500
Water Network+	1,783.914	(296.639)	1,487.275
Retail Household	17.419	(8.939)	8.480
Retail Non-Household	-	-	-
<b>Total</b>	<b>1,968.601</b>	<b>(339.346)</b>	<b>1,629.255</b>

### 2.9 ANALYSIS OF FIXED ASSET MOVEMENTS

The following tables and accompanying explanations detail the major differences between the fixed asset movements on capital additions, disposals and depreciation charged in year in relation to the current reporting year compared to the previous year. The financial data analysed below has been prepared following historic cost accounting rules.

The table below compares additions in the year to the previous year based on historic costs.

Description	2021 £m	2020 £m	Variance £m	Variance %
Water Resources additions	6.6	8.0	(1.4)	(17.5)
Water Network+ additions	83.5	92.7	(9.2)	(9.9)
Retail additions	0.5	0.9	(0.4)	(44.4)
<b>Total additions</b>	<b>90.6</b>	<b>101.6</b>	<b>(11.0)</b>	<b>(10.8)</b>

## 2 CAPITAL EXPENDITURE continued

The mix of asset types attracting capital expenditure changes from year to year. The decrease in additions within the water resources business unit is largely due to the purchase of abstraction licences for our site in Arlington in the previous year totalling £3.2 million. In the year we also saw a decrease in the water network+ additions, this change has been, for the most part, driven by the reduced costs incurred on the development of our Keleher Water Treatment Works which saw cost of £8.4 million in 2019/20 compared to £2 million in 2020/21. The spending in the retail business continues to be mainly on IT software and equipment.

The table below compares disposals in the year to the previous year based on historic costs.

Description	2021 £m	2020 £m	Variance £m	Variance %
Water Resources additions	(0.1)	-	(0.1)	-
Water Network+ additions	(3.0)	(1.7)	(1.3)	(76.5)
Retail additions	(0.3)	-	(0.3)	-
<b>Total additions</b>	<b>(3.4)</b>	<b>(1.7)</b>	<b>(1.7)</b>	<b>(100.0)</b>

The increase in disposals in the year compared with the prior year is largely due to the de-recognition of assets equating to £1.4 million, of which £1.3 million related to water network+. The disposals in the retail business relate to IT software and equipment.

The table below shows a comparison of depreciation between the past two years on an historic cost basis.

Description	2021 £m	2020 £m	Variance £m	Variance %
Water Resources disposals	0.1	-	0.1	-
Water Network+ disposals	2.2	1.5	0.7	46.7
Retail disposals	0.3	-	0.3	-
Water Resources charge for the year	(6.1)	(8.0)	1.9	(23.8)
Water Network+ charge for the year	(51.2)	(46.5)	(4.7)	10.1
Retail charge for the year	(1.2)	-	(1.2)	-

As with the increase in the cost of retail disposals in the year, the increase in depreciation on disposals relates to the disposal of IT software and equipment.

The variances on the depreciation charged in the year have been brought about by the alteration of the calculation method. As detailed within sections 2.5 and 2.8 of this accounting separation methodology statement, where previously depreciation would have been based pro rata on the current cost values brought forward from the previous year, following the analysis of the company's fixed asset register we are now able to calculate the split of depreciation based on the data held in the fixed asset register allowing for a more accurate calculation of this split.