SES Water

Accounting Separation Methodology Statement
for the year ended 31 March 2019

1) Introduction

This statement explains the way in which SES Water (trading name of Sutton and East Surrey Water plc, the ‘Company’) completes the analysis of costs between the relevant binding price controls (Wholesale and Household Retail) for the relevant tables in the Company’s 2019 Regulatory Accounts on pages 113, 114, 115, 116, 128 and 130, prepared in accordance with Information Notice 19/3, issued by Ofwat (the Water Services Regulatory Authority) in March 2019.

The statement is produced to meet the requirements of Ofwat’s guidelines for accounting information, as published in Regulatory Accounting Guidelines (RAGs) 1.08, 2.07, 3.11, 4.08 and 5.07 and associated materials including Information Notice 13/01 (Revised regulatory accounting guidelines and regulatory accounts reporting requirements for 2012-13 and onwards).

This methodology statement covers the following tables prepared by the Company:

Table 2A Segmental Income statement  Page 113
Table 2B Wholesale Totex Analysis    Page 114
Table 2C Operating Costs Analysis: Retail  Page 115
Table 2D Historic Cost Analysis of Fixed Assets – Wholesale & Retail  Page 116
Table 4D Wholesale Totex Analysis – Water (unaudited)  Page 128
Table 4F Cost Analysis – Household Retail (unaudited)  Page 130

Tables 2A, 2B, 2C and 2D have been audited by the Company’s external auditors (KPMG), who expressed an unqualified opinion that they conformed with Condition F of the Company’s Instrument of Appointment, the RAGs and the accounting policies set out on pages 73 to 78 of the Company’s 2019 Annual Report and in this accounting separation methodology statement.

In accordance with Ofwat’s requirements tables 4D and 4F are not subject to an audit opinion, however, these tables have been subject to proportionate assurance activity, including review and approval by relevant senior management and Directors to ensure that they have been completed appropriately.

It should be noted that SES Water is a water only company and has disposed of its Non-household retail business. Therefore, there is no Wholesale Wastewater or Non-household Retail information to be provided.
2) Process

2.1) General Comments and underlying principles

The general ledger in the Company’s accounting system (Navision) is the source for all the expenditure reflected in the operating cost analyses for the accounting separation tables. Transactions in the General Ledger all have cost centres and expense type account codes allocated at the time of their initial capture. The Company’s trial balance consists of around 3,500 of these cost centre and account combinations and so is readily manageable for manipulation in Excel to produce these accounting separation tables. Operating costs combinations make up around 3,000 lines of the trial balance.

Cost centres - For most operational areas, the cost centre is purpose (first two digits) and location (last 4 numbers) specific.

Accounts – there are a number of specific accounts which support the cost allocation process. For example, there is a specific account for abstraction costs.

Therefore, the cost centre and account code combination make it possible to allocate a significant portion of costs directly to the relevant accounting separation unit.

Operational costs which do not lend themselves to such direct allocation – typically covering site-wide, centralised, support, or management costs such as GIS and Health and Safety – are dealt with subsequently, allocated using appropriate cost drivers.

A mapping table is maintained showing how the cost centre and account combination is mapped, either directly to an accounting separation unit, or to a bucket for further allocation using an appropriate cost driver.

Based on the cost centre and account combination, allocation of an accounting separation code is possible for the majority of transactions, which are directly allocated in the Totex Analysis – Wholesale and Operating Cost Analysis - Retail tables because the original coding of transactions in the general ledger is well established, detailed and reliable.

The cost centre and account code structure has been in place since the early 1990’s and the employees involved in coding transactions for initial capture (those approving the original invoices) have generally been in post a number of years. They are therefore familiar with the requirement to ensure costs are captured with an appropriate degree of granularity.

Knowledge of the work undertaken/service provided is used to allocate a single invoice – for example for a series of repairs carried out across a number of locations – to the appropriate locational cost centre for capture in the General Ledger. Similarly, all internal costs are either location specific (for example, a works supervisor) or are charged to labour recharge rates which are then booked to location-specific activities by timesheets and job costing processes. This enables identification of the cost of work done at each site by, for example, mechanical and electrical maintenance gangs and consequently, by accounting separation activity classification.
For network activity, job-type codes enable identification of work undertaken by District Inspectors and works gangs by type of work. This enables appropriate classification to raw and treated water distribution and retail.

In addition, a number of the allocations are relatively straightforward given the size and the nature of SES Water:

- All abstraction charges are in a specific account and are allocated to water resources abstraction charges
- There are no bulk supply or bulk discharge costs
- No renewals expensed in the year (no longer use renewals accounting under IFRS/FRS101)
- All STOR income is allocated to Water Treatment
- All third-party services relate to Treated Water Distribution

This approach enables over 60% of total operating costs to be allocated directly in the Totex Analysis – Wholesale and Operating Cost Analysis - Retail tables in this initial step. The remaining costs are left in General and Support, Scientific Services, Rechargeable Works and Other Business Activities for allocation in subsequent steps. In Appendix 1 diagram 1 shows the subsequent steps in completion of the tables. Each step is described below.

2.3) Power costs

Power costs, predominantly electricity charges, are allocated between wholesale accounting separation units based on a management judgement of the relative uses of power at each site. This basis is used in the absence of sub-meters at sites. The splits were reviewed and confirmed as being accurate by operation management again in 2018/19.

2.4) Other operating charges – excluding renewals

Once the directly allocated costs have been apportioned across the accounting separation units the following allocations take place:

1) Scientific services are allocated using an activity-based model
2) Residual balances on Labour and Networks cost centres are allocated in line with direct manpower costs
3) Split cost centre balances (site specific costs) are allocated across Water Resources, Raw Water Distribution and Water Treatment in line with total directly allocated
4) Group services balances are then allocated using the following cost drivers:
As can be seen in the above table a number of the drivers have been updated for the year ended 31 March 2019 to enhance accuracy of allocations.

**Step 2**
Requires coding specific costs in the residual ‘General and Support’ pool to Direct costs of activities where this is known to be a requirement. This addresses a limited number of costs, including:

- Production Administration costs – split across wholesale business units in proportion to direct costs
- Water efficiency activities – from Treated Water Distribution to Retail; and
- Billing system costs – to Retail.

**Step 3**
General and Support costs are allocated between Wholesale and Retail using the following drivers:

- Corporate Services (Administration) FTE’s
- Amenities All Wholesale
- Compliance and Assurance FTE’s
- IT FTE’s
- Executive and Non-Executive Directors FTE’s
- Finance and Human Resources FTE’s
- Health & Safety FTE’s
- Innovation FTE’s
- Non-Operational Buildings Floor space
- Communications FTE’s

Cumulo Rates have been allocated based on CCA asset values and council tax has been allocated based on Floor Space.
Step 4
Allocate Laboratory and Water Quality costs (Scientific Services) to the reporting activity categories, based on separate analyses for sampling, laboratory analysis and process science activities. Sampling activities have been split 3.3%, 21.9%, 36.9% and 37.9% to Retail (for sampling at customers’ taps), Water Resources, Water Treatment, and Treated Water Distribution respectively based on a management review of sampling activities.

Step 5
Allocate Other Business Activities (costs of regulation) across reporting activity categories. This has been split equally across the business units, in line with Ofwat’s instruction to split the Ofwat licence fee accordingly.

This completes the cost allocations up to Total Operating Expenditure.
Retail

Direct costs are allocated to the Retail business unit as described in Step 1. Other costs are allocated to the Retail business unit as described in Steps 2 to 5. The company no longer has Non-Household customers and all costs are therefore allocated to Household.
Asset Methodology

A Company engineer has reviewed the asset database used for statutory and regulatory accounts purposes and an additional code has been added to each operational asset to indicate either its business unit, or that it is a General and Support or Scientific Services asset. Other tangible assets are already coded by their cost centre codes within the database, and each cost centre is allocated to a business unit, where possible. Where a cost centre spans business units, the asset is split in the same way as the operating expenditure for that cost centre has been split, for example by direct costs, direct employment costs, MEA asset values, etc.

The information is separated into Water Resources, Raw Water Distribution, Water Treatment, Treated Water Distribution, Retail, General and Support and Scientific Services. General and Support assets are allocated to the Wholesale business unit and the capital costs are recharged using the same drivers as used for operating expenditure.

The Scientific Services assets are allocated across Water Resources, Raw Distribution and Water Treatment pro rata to the Scientific Services operating expenditure.

The Retail assets are allocated to Household.
# Appendix 1

## Diagram 1: Steps in Completion of Activity Costing Analysis Tables

<table>
<thead>
<tr>
<th>Step</th>
<th>Unallocated Cost Pool</th>
<th>General and Support Pool</th>
<th>Direct Costs</th>
<th>Allocated Indexed Costs</th>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>Review Centre &amp; Account Code Combination</td>
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<td></td>
<td><strong>Balance</strong></td>
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<td>2.</td>
<td>Review specific 'Direct' costs</td>
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<td>3.</td>
<td>Allocate General and Support costs</td>
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<td>4.</td>
<td>Water Quality to Activities</td>
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<td>5.</td>
<td>Other Business Activities to Activities</td>
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